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National Bank of Fujairah PJSC

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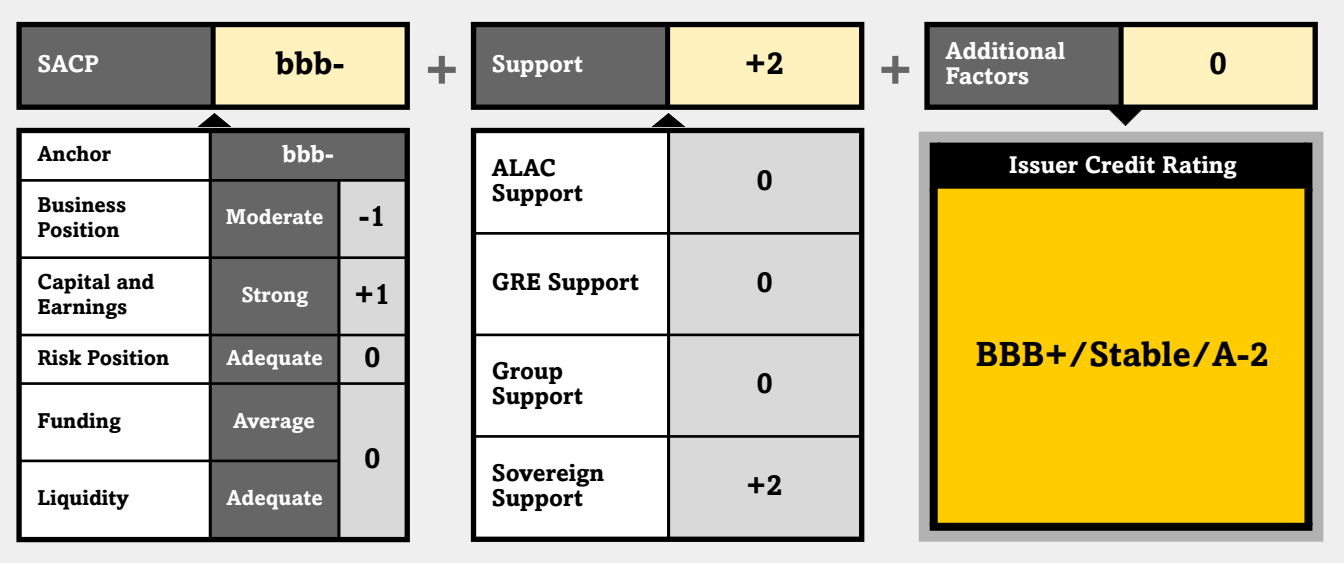
National Bank of Fujairah PJSC



Major Rating Factors

Strengths:	Weaknesses:
• Strong capitalization. • Healthy earnings generation and strong fee income. • A well-established franchise as a niche player in trade finance and business banking in the United Arab Emirates (UAE).	• High depositor concentrations. • Material level of restructured exposures, posing a potential threat to asset quality. • Limited geographic footprint.

Outlook: Stable

The stable outlook on the UAE-based National Bank of Fujairah PJSC (NBF) reflects our opinion that NBF's business and financial profiles will not change significantly over the next two years. We anticipate that NBF will remain a conservatively managed niche bank in the UAE's trade finance and business banking markets.

A positive rating action appears remote for the next 12-24 months.

On the other hand, we would consider a negative rating action if we observed higher-than-expected credit growth, or a significant rise in credit losses related to the bank's trade and receivables financing, or a deterioration in the bank's capitalization.

Rationale

The ratings on NBF factor in our 'bbb-' anchor for banks operating in the UAE and our view of the bank's moderate business position, strong capital and earnings, adequate risk position, average funding, and adequate liquidity. We

assess NBF's SACP at 'bbb-'.

The long-term rating on NBF is two notches higher than the SACP to incorporate our view of a moderately high likelihood that the UAE authorities would provide extraordinary support to NBF in the event of financial distress. We classify NBF as having moderate systemic importance and consider the authorities in the UAE to be highly supportive of the region's banking sectors.

Anchor: 'bbb-' for banks in the UAE

Our bank criteria use our Banking Industry Country Risk Assessment's 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 view the UAE's economy and its high income levels as key strengths. On the other hand, we expected the real estate price correction that started in early 2015 to continue in 2016. In addition, although banks' reported asset quality metrics are strong and have been improving over the past few years, many banks are structurally exposed to high single-name concentrations and there is a fair level of restructured exposures in the system.

With regard to industry risk, we believe that the UAE's institutional framework poses an intermediate risk, reflecting the large number of key regulations the authorities have implemented over the past five years. Although UAE banks operate with healthy profitability metrics, a large number of key banks are controlled by either government-based institutions or ruling families, which we believe is a weakness in terms of competitive dynamics. UAE banks have improved their funding profiles over the past few years as credit growth has lagged behind deposit growth. We still consider that funding conditions pose intermediate risk.

Table 1

National Bank of Fujairah PSC Key Figures

		--Year-ended Dec. 31--			
(Mil. AED)	**2016***	**2015**	**2014**	**2013**	**2012**
Adjusted assets	32,101.1	30,010.2	24,559.6	21,435.7	17,531.6
Customer loans (gross)	21,966.5	20,742.6	17,253.3	14,679.7	12,680.5
Adjusted common equity	3,291.9	3,175.8	2,755.9	2,371.3	2,142.4
Operating revenues	336.3	1,213.1	1,025.2	884.7	759.5
Noninterest expenses	113.2	446.2	387.4	324.0	280.0
Core earnings	150.5	558.8	505.4	393.1	305.8

*Data as of March 31. AED--UAE dirham.

Business position: Corporate niche player with a focus on trade finance market

We regard NBF's business position as moderate. Our assessment reflects the bank's limited market share and niche focus. Nevertheless, we still recognize the bank's revenue generation capacity has been similar to that of rated domestic peers over the past few years. As a bank with a strong focus on trade finance, NBF traditionally generates a larger portion of its revenues from fee income compared with its UAE-based peers. The bank operates with very limited exposure to capital markets, and all of its revenues come from its local lending operations and trade finance activities. We consider NBF's pre-provision earnings to be quite predictable because the contribution of market-related

income to revenues is limited.

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

As of year-end 2015, the Fujairah government, through the Department of Industry and Economy, owned 40.1% of the bank; 21.7% is owned by Easa Saleh Al Gurg LLC; 9.8% by Investment Corporation of Dubai--an investment arm of the Dubai government--and 5.2% by Al Fujairah Investment Company. 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 small proportion of NBF's lending book, we understand that the bank has preferential access to important infrastructure projects in the emirate.

Table 2

National Bank of Fujairah PSC Business Position

		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Total revenues from business line (currency in millions)	336.3	1,213.1	1,025.2	884.7	759.5
Commercial banking/total revenues from business line	72.7	75.5	76.5	80.2	85.5
Retail banking/total revenues from business line	7.5	7.4	7.4	7.3	7.1
Commercial & retail banking/total revenues from business line	80.2	82.8	83.9	87.5	92.6
Trading and sales income/total revenues from business line	19.8	17.2	16.1	12.5	7.4
Investment banking/total revenues from business line	19.8	17.2	16.5	12.5	8.0
Return on equity	14.0	14.6	15.8	14.8	14.1

*Data as of March 31.

Capital and earnings: Improving capital ratios

We regard NBF's capital and earnings position as strong. This reflects our projected risk-adjusted capital (RAC) ratio for NBF (before adjustments) will remain at 13%-14% over the next 18–24 months, in line with healthy earnings generation. As of year-end 2014, the bank had a regulatory Tier I capital ratio of 15.7% (up from 14.6% in 2014), and the RAC ratio (before adjustments) stood at 13.1%. NBF's RAC ratio compares favorably with the global industry average and indicates strong capital, according to our criteria.

During 2014, NBF took constructive steps to improve its capitalization. It issued a second Tier I perpetual note of UAE dirham (AED) 500 million (about $136 million) in March 2015. The first tranche, in the same amount, was issued in March 2013. Under our criteria, these instruments have intermediate equity content, but also result in a slight deterioration in the quality of capital because hybrids now account for a larger portion of NBF's total adjusted capital. The bank also maintained its stock dividend policy introduced in 2014, under which it distributes only half of its dividends in cash. As a result, similar to the previous year, the bank was able to retain 84% of its earnings in its equity base.

We forecast the RAC ratio to remain comfortably in the 13%-14% range over the next 12-24 months, assuming:

- Lending growth of about 12% per year over the next two years;

- A continued moderate compression of the net interest margin due to lower liquidity in the market, accompanied by strong growth of fee income;
- A slight increase in the cost-to-income ratio, which should remain below 35%, however;
- Some deterioration in asset quality, with nonperforming loans (NPLs) remaining below 6% over our forecast horizon. We also expect an increase in the cost of risk to around 120bps-140bps, allowing for a NPL coverage level remaining at 100%-110%; and
- A stable dividend payout in proportion of net income.

Based on our calculations, the three-year average earnings buffer for NBF stands at about 1.8%, which indicates a very good capacity for earnings to cover expected losses over a complete cycle.

Table 3

National Bank of Fujairah PSC Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Tier 1 capital ratio	15.4	15.7	14.6	15.7	13.6
S&P RAC ratio before diversification	N.M.	13.1	13.1	12.2	N.M.
S&P RAC ratio after diversification	N.M.	11.1	10.6	11.5	N.M.
Adjusted common equity/total adjusted capital	76.7	76.1	84.6	82.6	100.0
Net interest income/operating revenues	61.8	66.1	66.4	65.8	66.5
Fee income/operating revenues	27.4	24.2	24.6	25.2	23.9
Market-sensitive income/operating revenues	7.4	7.7	7.4	7.8	7.8
Noninterest expenses/operating revenues	33.7	36.8	37.8	36.6	36.9
Preprovision operating income/average assets	2.9	2.8	2.8	2.9	3.0
Core earnings/average managed assets	1.9	2.0	2.2	2.0	1.9

*Data as of March 31. N.M.--Not meaningful.

Table 4

National Bank of Fujairah PJSC RACF [Risk-Adjusted Capital Framework] Data

(AED 000s)	**Exposure***	**Basel II RWA**	**Average Basel II RW (%)**	**Standard & Poor's RWA**	**Average Standard & Poor's RW (%)**
Credit risk					
Government and central banks	4,597,953	--	--	229,898	5
Institutions	4,275,245	--	--	1,600,422	37
Corporate	22,349,544	--	--	24,081,573	108
Retail	2,409,831	--	--	2,017,688	84
Of which mortgage	779,066	--	--	350,580	45
Securitization§	0	--	--	0	0
Other assets	992,223	--	--	1,521,816	153
Total credit risk	34,624,797	--	--	29,451,396	85
Market risk					
Equity in the banking book†	9,558	--	--	88,350	924
Trading book market risk	--	--	--	53,892	--
Total market risk	--	--	--	142,242	--

Table 4

National Bank of Fujairah PJSC RACF [Risk-Adjusted Capital Framework] Data (cont.)

Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	0	--	2,274,557	--
(AED 000s)		**Basel II RWA**		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
Diversification adjustments					
RWA before diversification		23,960		31,868,195	100
Total Diversification/Concentration Adjustments		--		5,820,905	18
RWA after diversification		23,960		37,689,100	118
(AED 000s)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**Standard & Poor's RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		4,198,712	15.7	4,175,799	13.1
Capital ratio after adjustments‡		4,198,712	15.7	4,175,799	11.1

*Exposure at default. §Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital.AED--United Arab Emirates Dirham. Sources: Company data as of Dec. 31, 2015, Standard & Poor's.

Risk position: Asset quality metrics expected to deteriorate

We assess NBF's risk position as adequate. In 2015, NPLs rose by 29% and accounted for 4.7% of gross loans, up from 4.4% in 2014. Moreover, given its focus on customers ranging from medium enterprises to small corporates, we expect the current slowdown in economic growth in the UAE to translate into an additional deterioration in the bank's asset quality.

In addition, restructured loans not classified as NPLs rose by 86% and accounted for 9% of gross loans at year-end 2015. If some restructured exposures were to become NPLs, we believe NBF's strong loan loss coverage ratio and capitalization would still provide it with adequate loss-absorption capacity.

As a niche player in trade finance, the bank operates with lower single-party concentrations than its peers. The 20-largest private sector lending exposures represented about 21% of NBF's gross loans at year-end 2015, compared with 30%–35% for other banks we rate in the UAE. Similarly, NBF exhibits lower real estate- and construction-funded exposures. For example, as of year-end 2014, loans to these sectors comprised about 6% of the loan book, compared with more than 25% for most banks in the region.

Table 5

National Bank of Fujairah PSC Risk Position

		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Growth in customer loans	5.9	20.2	17.5	15.8	14.8
Total diversification adjustment / S&P RWA before diversification	N.M.	18.3	23.5	5.9	N.M.

Table 5

National Bank of Fujairah PSC Risk Position (cont.)

		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Total managed assets/adjusted common equity (x)	9.8	9.5	8.9	9.0	8.2
New loan loss provisions/average customer loans	0.3	1.1	0.8	1.2	1.5
Net charge-offs/average customer loans	N.M.	0.4	0.2	1.0	0.3
Gross nonperforming assets/customer loans + other real estate owned	4.8	4.7	4.4	4.7	7.8
Loan loss reserves/gross nonperforming assets	107.3	107.7	121.4	118.4	79.7

*Data as of March 31. N.M.--Not meaningful.

Funding and liquidity: Healthy liquidity and funding metrics

We consider NBF's funding average and its liquidity adequate. The bank funds itself predominantly from domestic customer deposits. As of year-end 2015, NBF's loan-to-deposit ratio stood at 91% and the ratio of stable funding resources to its funding needs was a healthy 117%, according to our calculations. Like other rated banks in the UAE, NBF exhibits funding concentrations. The 20-largest deposits represented about 53% of NBF's deposit base at year-end 2015. We expect deposits from NBF's shareholders and affiliated entities to remain stable, but note a significant reliance on deposits from other institutions.

The bank operates with a highly liquid balance sheet, and at year-end 2015 had more than $1.2 billion with the Central Bank of the United Arab Emirates in the form of certificates of deposit and other placements. NBF's ratio of broad liquid assets to short-term wholesale funding was a healthy 4.2x at year-end 2015.

Table 6

National Bank of Fujairah PSC Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Core deposits/funding base	88.7	89.2	90.6	87.0	84.7
Customer loans (net)/customer deposits	90.1	91.1	91.1	92.4	101.3
Long term funding ratio	93.1	93.8	95.3	91.7	95.5
Stable funding ratio	116.8	117.3	116.2	112.3	106.5
Short-term wholesale funding/funding base	8.1	7.3	5.5	9.7	5.3
Broad liquid assets/short-term wholesale funding (x)	3.9	4.2	5.5	3.1	4.8
Net broad liquid assets/short-term customer deposits	28.7	29.1	30.4	25.2	27.5
Short-term wholesale funding/total wholesale funding	53.4	48.8	46.2	61.2	26.6
Narrow liquid assets/3-month wholesale funding (x)	5.2	5.5	7.1	3.9	6.4

*Data as of March 31.

Support: Moderate systemic importance in a highly supportive country

The long-term rating is two notches higher than the SACP to incorporate our view of a moderately high likelihood of extraordinary government support for NBF if needed. This is in line with the bank's moderate systemic importance in the UAE and our assessment of the UAE government as highly supportive toward the domestic banking sector.

Related Criteria And Research

Related Criteria

- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Related Research

- UAE Banks: Earnings To Decline in 2016 As Operating Conditions Weaken, Jan. 11, 2016
- Gulf Banks: After Solid First-Half Results, Earnings Are Set To Slide, Oct. 1, 2015
- Gulf Banks Are Well-Positioned To Withstand Rougher Waters Ahead, June 9, 2015
- Banking Industry Country Risk Assessment: United Arab Emirates, May 5, 2015
- UAE Banks Are Well-Positioned To Face A Tougher 2015, Feb. 15, 2015

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	**5**	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	**bbb-**	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of May 17, 2016)

National Bank of Fujairah PJSC	
Counterparty Credit Rating	BBB+/Stable/A-2
Counterparty Credit Ratings History	
31-Mar-2014	BBB+/Stable/A-2
Sovereign Rating	
Abu Dhabi (Emirate of)	AA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable

Ratings Detail (As Of May 17, 2016) (cont.)

across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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