

## CREDIT OPINION

14 April 2017

Update

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### RATINGS

#### National Bank of Fujairah

Domicile	Fujairah, United Arab Emirates
Long Term Deposit	Baa1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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# National Bank of Fujairah

## Semiannual Update

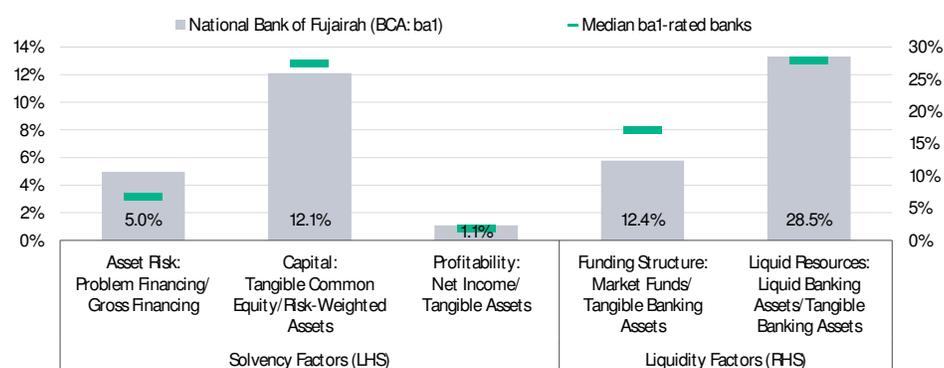
### Summary Rating Rationale

National Bank of Fujairah's ba1 BCA reflects the bank's solid profitability, sound capital buffers, and stable funding and liquidity. However, the bank's weakening asset quality and limited business diversification moderate these strengths.

The bank's Baa1 long-term deposit rating reflects its ba1 BCA and our assessment of a 'very high' probability of government support in case of need. This reflects the Government of Fujairah's 40.2% ownership stake and the UAE authorities historical support banks in case of need.

National Bank of Fujairah was founded in 1982 in the Emirate of Fujairah and commenced banking operations in 1984. The bank provides corporate banking, business banking, treasury and trade finance services to individuals, companies, financial institutions and government agencies, along with an expanding suite of personal banking and Shari'a-compliant services. The bank operates primarily in the UAE, where it has a market share of 1.4% in terms of total assets as of end-December 2016.

Exhibit 1  
Rating Scorecard - Key Financial Ratios



Note: The problem loan and profitability ratios are the weaker of the average 3-year ratios and the latest reported ratios. The capital ratio is the latest reported figure. The funding structure and liquid resources ratios are the latest year-end figures.  
Source: Moody's Investors Service

## Credit Strengths

- » Established corporate and business banking franchise with a niche in trade finance supports solid earnings generation
- » Sound capital buffers reflect solid earnings generation and retention
- » Stable corporate and business banking deposit base and limited maturity transformation drive solid funding and liquidity profile
- » Very high likelihood of public support from UAE authorities in case of need

## Credit Challenges

- » Exposure to the business banking segment will continue to drive weakening in the assets quality metrics given the softer operating environment
- » Limited business diversification

## Rating Outlook

The rating outlook reflects our expectation that NBF's solid profitability and sound capital buffers will help it weather the softer economic growth, despite its weakening asset quality and limited business diversification.

## Factors that Could Lead to an Upgrade

Upward pressure on NBF's ratings could develop from (1) a material improvement in the business diversification; and/or (2) a significant reduction in the borrower and deposit concentrations.

## Factors that Could Lead to a Downgrade

Downward pressure on NBF's ratings could develop from (1) a significant continued deterioration in the asset risk metrics; and/or (2) a further material weakening in the capital buffers; and/or (3) a material weakening in the bank's funding and liquidity metrics.

## Key Indicators

Exhibit 2

### NATIONAL BANK OF FUJAIRAH (Consolidated Financials) [1]

	12-16 <sup>2</sup>	12-15 <sup>2</sup>	12-14 <sup>2</sup>	12-13 <sup>2</sup>	12-12 <sup>2</sup>	Avg.
Total Assets (AED million)	35,668	30,033	24,586	21,458	17,545	19.4 <sup>3</sup>
Total Assets (USD million)	9,711	8,177	6,694	5,842	4,777	19.4 <sup>3</sup>
Tangible Common Equity (AED million)	3,589	3,287	2,835	2,507	2,247	12.4 <sup>3</sup>
Tangible Common Equity (USD million)	977	895	772	682	612	12.4 <sup>3</sup>
Problem Loans / Gross Loans (%)	5.0	4.7	4.4	4.7	7.6	5.3 <sup>4</sup>
Tangible Common Equity / Risk Weighted Assets (%)	12.1	12.3	12.6	13.6	14.1	13.0 <sup>5</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	24.9	22.6	20.3	20.7	32.6	24.2 <sup>4</sup>
Net Interest Margin (%)	2.4	2.7	2.9	3.0	3.2	2.8 <sup>4</sup>
PPI / Average RWA (%)	2.8	2.8	2.9	3.2	3.2	3.0 <sup>5</sup>
Net Income / Tangible Assets (%)	1.1	1.7	1.9	1.8	1.7	1.6 <sup>4</sup>
Cost / Income Ratio (%)	36.3	38.4	39.1	37.3	36.9	37.6 <sup>4</sup>
Market Funds / Tangible Banking Assets (%)	12.4	11.5	10.8	13.2	15.1	12.6 <sup>4</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	28.5	28.0	27.2	29.2	21.9	27.0 <sup>4</sup>
Gross loans / Due to customers (%)	92.6	96.0	96.2	97.9	113.9	99.3 <sup>4</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Compound Annual Growth Rate (%). Any interim period amounts presented are assumed to be fiscal year end amounts for calculation purposes [4] Simple average of periods presented [5] Simple average of Basel II periods presented

Source: Moody's Financial Metrics

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 [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Detailed Rating Considerations

### A 'STRONG-' MACRO PROFILE SUPPORTS NATIONAL BANK OF FUJAIRAH'S RATINGS

The bank's standalone profile takes into account its operations in UAE (Strong-), where the 97% of the funded exposures were located as of year-end (YE) 2016. National Bank of Fujairah benefits from 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 continues to drive economic diversification that 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 resilience of Dubai's diversified non-oil private sector.

The substantive sovereign wealth fund buffers and relatively low debt levels 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 rating of the UAE government is Aa2 with a negative outlook.

### EXPOSURE TO THE BUSINESS BANKING SEGMENT WILL CONTINUE TO DRIVE WEAKENING IN THE ASSETS QUALITY METRICS GIVEN THE SOFTER OPERATING ENVIRONMENT

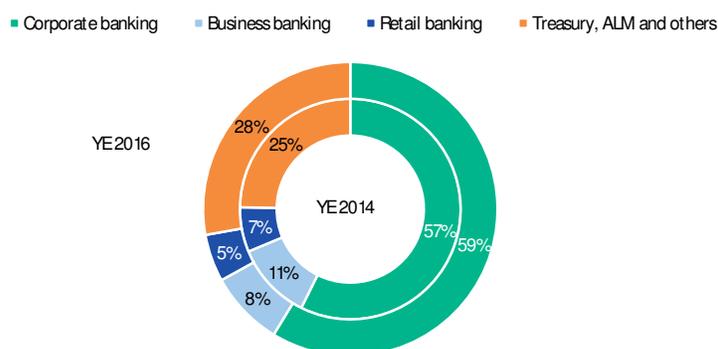
We expect National Bank of Fujairah's asset quality to remain pressured, as the lower economic growth and business confidence in the United Arab Emirates negatively affects the creditworthiness of SMEs and mid corporates, the latter being the bank's core customer base.

The bank's borrower concentration, which reflects the country's limited economic diversification, continue to pose risks to the asset quality.

National Bank of Fujairah's relatively rapid credit growth also moderates its asset quality. Such growth, at 16% of gross loans growth in 2016 (4% local average), limits the seasoning of the book and poses challenges for the bank's operational and underwriting controls. Nevertheless, the short-term nature of the bank's balance sheet (71% of assets had a maturity of less than one year at YE 2016) has allowed a re-orientation to its recent growth towards lower risk exposures (see exhibit 3).

Exhibit 3

#### Assets Breakdown by Banking Activity



Source: National Bank of Fujairah's Financial Statements

As of December 2016, the bank's problem loans to gross loans ratio (including loans that are more than 90 days past due but not impaired) increased to 5.0% (4.7% at YE 2015), which is in line with the 5.1% UAE average and higher than the 3.2% ba1 global median. The loan loss reserve-to-problem loans ratio stood at 101% (108% at YE 2015), higher than the 94% local average.

### **SOUND CAPITAL BUFFERS REFLECT SOLID EARNINGS GENERATION AND RETENTION**

We expect National Bank of Fujairah's sound capitalisation metrics to remain broadly stable above the management minimum target of 14%-16% Tier 1 ratio and 16%-18% capital adequacy ratio. The bank will meet future capital requirements arising from its rapid growth through continued high retained earnings (16% cash dividend pay-out for 2015 paid in 2016), and some hybrid capital issuance.

As of December 2016, the bank reported a tangible common equity to RWAs ratio of 12.1% (12.3% as of YE 2015), which compares unfavourably with the 12.8% ba1 global median and the 13.8% system average. The bank's Basel II Tier 1 ratio of 15.2%, total capital adequacy ratio of 17.6% and shareholder's equity (excluding Tier 1 capital notes) to total assets ratio of 10.0% were adequate with its risk profile.

### **ESTABLISHED CORPORATE AND BUSINESS BANKING FRANCHISE WITH A NICHE IN TRADE FINANCE SUPPORTS SOLID EARNINGS GENERATION**

We expect the bank's healthy profitability to remain stable through 2017, above global peers. Solid credit growth volumes combined with a stabilisation of funding and operating cost will help balance the elevated provisioning charges as problem loans formation continues.

Higher interest income will contribute to the profitability, as the bank continues to grow faster than the system (at ca. 8% in 2017). This rapid growth will reflect the bank's industry focus and expertise, the bank's flexibility resulting from the short-term nature of its balance sheet, as well as its small market share. In addition, we expect the bank's niche franchise in trade finance to continue to contribute to the top line profitability through significant non-interest income. Non-interest income accounted for 36% of the operating income in 2016.

Net interest margins declined to 2.4% in 2016 from 2.7% in 2015, as the tighter funding environment pressured the funding cost (1.8% in 2016, from 1.4% in 2015). The bank's high reliance on term deposits (70% of deposits at YE 2016), which reflects its limited retail franchise, contributed to the increase in the funding cost. The bank's cost-to income ratio was stable at 36% in 2016 (36% local average). Loan loss provisions consumed 51% of the pre-provision income (28% system average), from 29% in 2015, owing to higher delinquencies in the business banking segment.

### **STABLE CORPORATE AND BUSINESS BANKING DEPOSIT BASE COMBINED WITH LIMITED MATURITY TRANSFORMATION DRIVE SOLID FUNDING AND LIQUIDITY PROFILE**

We expect the National Bank of Fujairah's market funding reliance and liquid assets stock to remain stable despite the tighter funding environment in the region, reflecting its corporate deposit gathering abilities. The bank's net loans to deposits ratio improved to 88% in 2016 (91% in 2015), reflecting solid deposit growth despite a tighter funding environment.

Moreover, the short-term nature of the bank's balance sheet (71% of assets had a maturity of less than one year at YE 2016) limits the maturity transformation, which reduces the risk of liquidity pressures.

However, the bank exhibits a concentrated funding base towards corporate deposits, which exposes it to volatility in a tighter liquidity environment. Nevertheless, a material portion of the bank's deposits (18% of deposits at YE 2016) are sourced from related parties, which have historically been stable.

As of December 2016, the bank's market funds to tangible banking assets ratio stood at 12.4% (11.5% at YE 2015), which is lower than the 17.8% local average and 17.2% ba1 global median. As of December 2016, 14% of the bank's total market funding had a maturity of

more than a year. As of December 2016, the bank's liquid banking assets to tangible banking assets ratio stood at 28.5% (28% at YE 2015), in line with the 28% UAE average and the 28% ba1 global median.

### LIMITED BUSINESS DIVERSIFICATION

National Bank of Fujairah's limited diversification constrains its standalone profile since it increases the bank's earnings sensitivity. Indeed, the bank's corporate and business banking activities represented 72% of the operating profit as of YE 2016, constrains NBF's income profile.

### Notching Considerations

#### GOVERNMENT OWNERSHIP AND UAE AUTHORITIES' TRACK RECORD SUPPORT OUR VIEW THAT NBF WOULD RECEIVE SUPPORT IN CASE OF NEED

NBF's Baa1 deposit rating incorporates, that translates into a three-notch uplift from its ba1 BCA, based on Moody's assessment of a very high likelihood of government support in case of need. This reflects (1) the Government of Fujairah direct and indirect ownership stake (40.2% direct and 5.2% through the Fujairah Investment Company), combined with the Government of Dubai's stake (9.8% through the Investment Corporation of Dubai), as well as (2) the UAE's strong track record of supporting banks in times of stress.

#### RATIONALE FOR ASSIGNING COUNTERPARTY RISK ASSESSMENT

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

The CR Assessment is positioned at A3(cr). The CR Assessment, prior to government support, is positioned one notch above the Adjusted BCA of ba1 and therefore above deposit ratings, reflecting our view that its probability of default is lower than that of deposits. We believe senior obligations represented by the CR Assessment will be more likely preserved in order to limit contagion, minimize losses and avoid disruption of critical functions.

The CR Assessment also benefits from three notches of systemic support, in line with our support assumptions on deposits. This reflects our 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 Assessment as well, consistent with our 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.

#### Source of facts and figures cited in this report

The system averages quoted in the report updated as of June 2016, unless otherwise stated, and based on available audited system metrics. The global medians quoted in the report are updated as of March 2017 and are calculated using the most recent year-end financial data. 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

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard 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 Methodology and Scorecard Factors

Exhibit 4

### NATIONAL BANK OF FUJAIRAH

#### Macro Factors

**Weighted Macro Profile**                      **Strong - 100%**

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	5.0%	baa3	↓	b1	Loan growth	Single name concentration
Capital						
TCE / RWA	12.1%	baa3	← →	baa3	Expected trend	
Profitability						
Net Income / Tangible Assets	1.1%	baa2	↓	baa3	Loan loss charge coverage	
Combined Solvency Score		baa3		ba2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	12.4%	a3	↓	baa2	Deposit quality	Expected trend
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	28.5%	baa2	↓	baa3	Expected trend	
Combined Liquidity Score		baa1		baa2		
Financial Profile						
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aa2		
Scorecard Calculated BCA range				baa3-ba2		
Assigned BCA				ba1		
Affiliate Support notching				0		
Adjusted BCA				ba1		

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	1	0	baa3 (cr)	3	A3 (cr)	--
Deposits	0	0	ba1	3	Baa1	Baa1

Source: Moody's Financial Metrics

## Ratings

Exhibit 5

Category	Moody's Rating
<b>NATIONAL BANK OF FUJAIRAH</b>	
Outlook	Stable
Bank Deposits	Baa1/P-2
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	A3(cr)/P-2(cr)

Source: Moody's Investors Service

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