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National Bank of Fujairah PJSC

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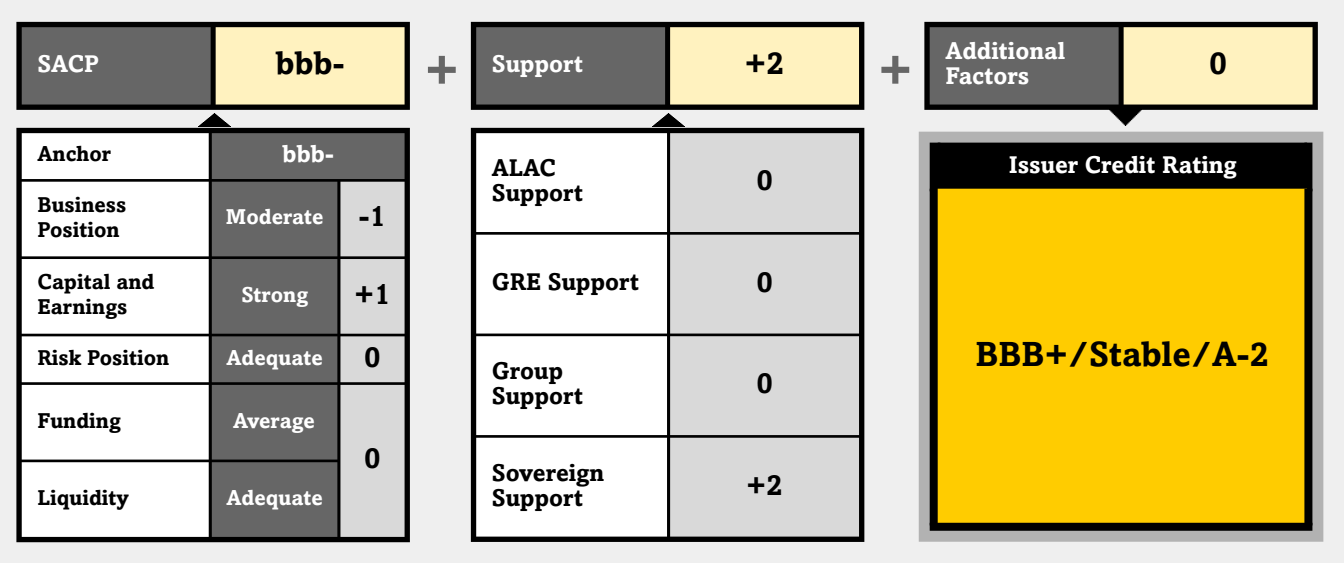
National Bank of Fujairah PJSC



Major Rating Factors

Strengths:	Weaknesses:
• Strong capital buffers. • Sound financial performance. • A well-established niche franchise.	• A significant, but reducing, amount of problematic assets. • High depositor and geographic concentration.

Outlook: Stable

The stable outlook on United Arab Emirates (UAE)-based National Bank of Fujairah PJSC (NBF) reflects S&P Global Ratings' opinion that the bank's sound profitability and strong capitalization will protect its creditworthiness from increasing credit losses on legacy lending relationships. We expect NBF's overall business and financial profiles to remain broadly unchanged over the next 12-24 months.

We could raise our ratings in the next 12-24 months if NBF showed lower geographic concentration and a more diversified business profile, along with strengthening capitalization, with a risk-adjusted capital (RAC) ratio sustainably exceeding 15%. The latter could be achieved through stronger profitability and consistently conservative dividend payouts.

We would consider a negative rating action over the next 12-24 months if we see a significant deterioration in the bank's asset quality indicators, potentially arising from increasing problematic loans on legacy lending relationships.

Rationale

The ratings reflect NBF's well-established position in the corporate middle market and its smaller franchise compared with peers in the Gulf Cooperation Council (GCC) countries. We view the bank's capitalization as a positive factor, underpinned by our forecast that our RAC ratio before concentration adjustments will remain between 11.5% and 12.5% over the next 12-24 months. Although the bank displayed improved asset-quality indicators, it continues to carry a substantial amount of problematic loans, mostly arising from legacy lending relationships. Nevertheless, we believe that the asset quality indicators will gradually improve over the next 12-24 months as the bank continues to clean its legacy portfolio and move cautiously with new lending. In our view, the funding and liquidity profiles of NBF are on par with domestic peers and do not detract or enhance NBF's credit quality.

The long-term rating on NBF is two notches above its intrinsic creditworthiness, given our view of the bank's moderately high systemic importance in the UAE, which we regard as highly supportive of the domestic banking sector.

Anchor: 'bbb-' for banks operating only in the UAE

We 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'.

With regard to economic risk, we view the UAE's high-income levels and strong fiscal and external positions as key strengths. The exceptional strength of the government's net asset position has counteracted the negative effect of lower oil prices on economic growth since late 2015. With oil prices stabilizing and economic growth rebounding, we see a degree of stabilization in the financial profiles of UAE banks. The country's real estate price market remains in a correction phase, which we expect will continue in 2019 before stabilizing in 2020. Nevertheless, under our base-case scenario, repercussions will remain contained given improved regulatory oversight and better underwriting standards.

Our assessment of industry risk reflects our view that the institutional framework in the UAE has improved in recent years, and banking regulations are broadly in line with international peers. UAE banks traditionally operate with healthy profitability and capitalization, and we do not expect this trend to change in 2019-2020. However, we expect deposit growth to slow down in 2019, due to planned spending and investments on the back of Abu Dhabi's $13.6 billion stimulus package and Dubai's hosting of the Expo in 2020. In our view, system wide funding will continue to benefit from a sizable share of government and government-related entity (GRE) deposits.

Table 1

National Bank of Fujairah PJSC Key Figures

		--Year-ended Dec. 31--			
(Mil. AED)	**2019***	**2018**	**2017**	**2016**	**2015**
Adjusted assets	38,012.7	37,756.7	35,266.6	34,009.1	28,893.9
Customer loans (gross)	27,424.3	27,367.2	25,320.0	24,023.4	20,742.6
Adjusted common equity	4,454.1	4,260.0	3,792.2	3,493.3	3,175.8
Operating revenues	415.5	1,573.8	1,378.5	1,319.1	1,213.1

Table 1

National Bank of Fujairah PJSC Key Figures (cont.)

		--Year-ended Dec. 31--			
(Mil. AED)	**2019***	**2018**	**2017**	**2016**	**2015**
Noninterest expenses	130.4	521.7	464.9	453.1	446.2
Core earnings	167.6	615.3	471.9	460.4	558.8

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

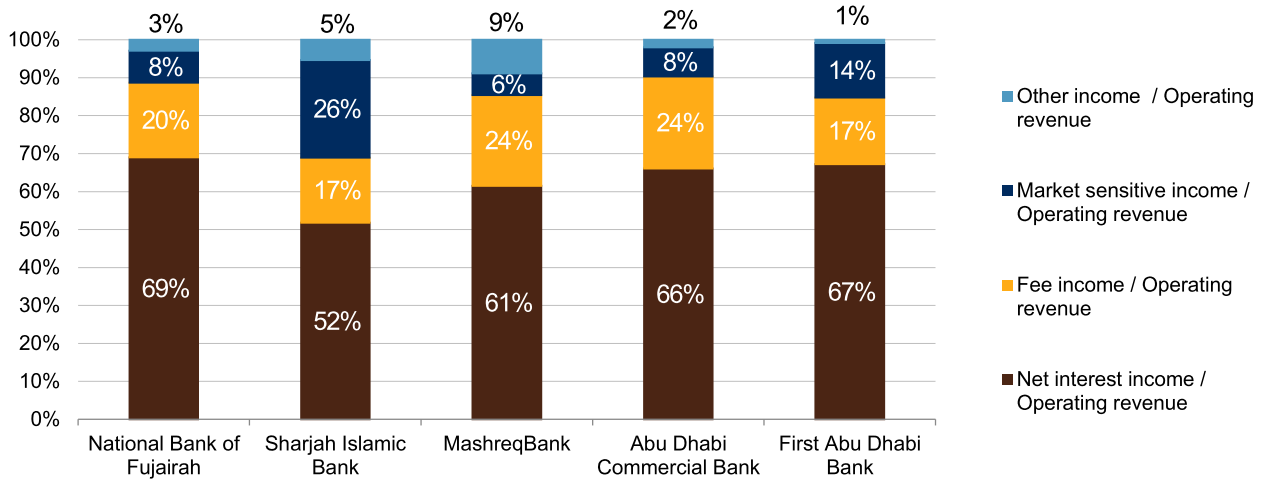
Business position: A well-established niche franchise

We think NBF's business position benefits from its well-established position in the corporate middle market, which supports its solid earnings generation. With assets totaling UAE dirham (AED) 40.0 billion ($10.9 billion) on March 31, 2019, NBF has a market share of about 1.7% in lending and 1.8% in deposits.

The bank's geographic diversification remains limited and it operates primarily in the UAE. Within the UAE, NBF derives material business from Dubai, where it generates about 60% of its total revenue. Lately, the bank has been widening its geographical presence in other emirates as well. Nevertheless, we anticipate that a substantial portion of its lending and revenue will continue to come from Dubai in the medium term. NBF has a strong focus on trade finance, with a market share of 5.8% as of Dec. 31, 2018. The bank traditionally generates a large portion of its revenue from fee income in line with its UAE-based peers. We consider NBF's pre-provision earnings to be predictable because most revenue is generated from net-interest income.

Chart 1

UAE Banks' Revenue Distribution



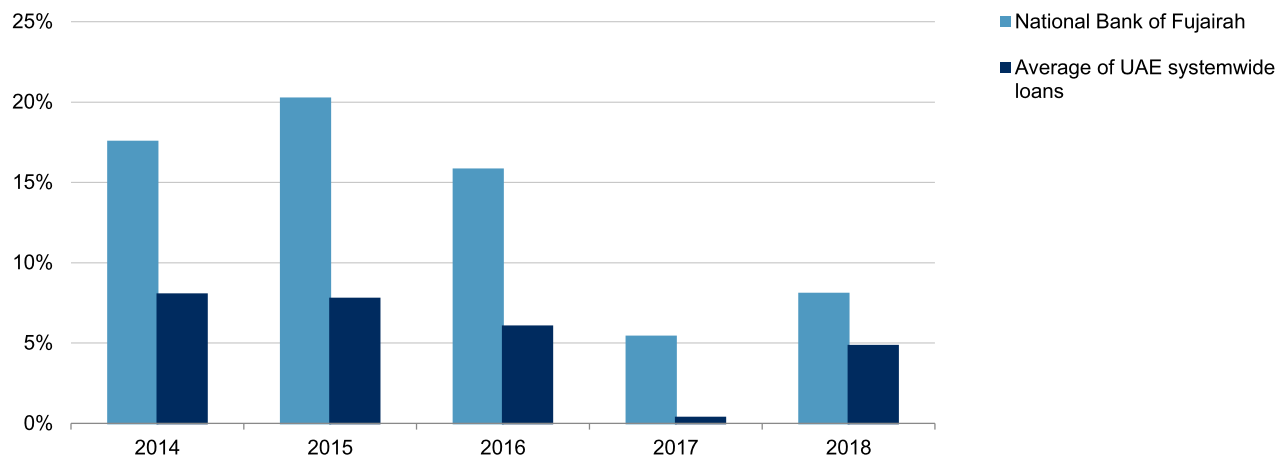
Source: S&P Global Ratings.

The bank has been diversifying into Sharia-compliant banking services, which represented 7.3% of overall operating income on Dec. 31, 2018. The bank has displayed above-sector lending growth in the past five years, mostly coming from its niche trade finance operations, and new business lines it has ventured into since 2014. NBF's gross loans

increased by 13.4% on average between 2014 and 2018, versus 5.4% for the UAE banking sector. Nevertheless, growth moderated in 2017-2018 because of the slowdown in the economy, as well as the bank management's decision to manage growth cautiously. We expect lending growth of about 10% annually over the next two years, driven by a gradual recovery in the UAE economy and NBF's smaller base compared with peers.

Chart 2

National Bank Of Fujairah's Gross Loan Growth Is Above The UAE Average



UAE--United Arab Emirates. Source: S&P Global Ratings.

As of year-end 2018, the Fujairah government, through the Department of Industry and Economy, owned 40.67% of NBF's share capital. In our opinion, NBF has an experienced and stable management, with a track record of protecting the bank's business franchise.

Table 2

National Bank of Fujairah PJSC Business Position

		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Total revenue from business line (currency in millions)	415.5	1,573.8	1,378.5	1,319.1	1,213.1
Commercial banking/total revenue from business line	72.1	75.4	75.0	74.1	75.5
Retail banking/total revenues from business line	8.3	8.7	8.2	7.6	7.4
Commercial & retail banking/total revenue from business line	80.4	84.1	83.2	81.7	82.8
Trading and sales income/total revenue from business line	19.6	15.9	16.8	18.3	17.2
Return on average common equity	14.4	14.5	12.6	13.4	18.2

*Data as of March 31.

Capital and earnings: Steady internal capital generation supports strong capitalization

Capital is a rating positive for NBF as shown by our RAC ratio (before diversification adjustments), which we forecast will remain at 11.5%-12.5% over the next 12-24 months, compared with 11.6% at year-end 2018. NBF plans to

strengthen the capital structure by raising $350 million through the issuance of an additional Tier 1 (AT1) instrument this year, which will increase the RAC ratio to 13.5%-14.0% over the next 12-24 months. NBF converted its first tranche of existing AT1s of AED500 million into paid-up capital in September 2018 and repaid a Tier 2 capital instrument of AED400 million in November 2018. Its regulatory total and Tier 1 capital ratios under Basel III stood at 15.9% and 14.7%, respectively as of March 31, 2019, and are well above the local regulatory minimum.

Since 2014, NBF's capitalization benefited from a reduction in its cash dividend payout ratio, which declined from 35% in 2013 to 20%-25% in recent years. NBF's profitability improved in 2018, with return on average assets rising to 1.6% in 2018 from 1.3% in 2017, underpinned by higher margins. We expect profitability to remain stable as funding costs stabilize. Strong lending growth and stable profitability will provide a substantial buffer against increasing credit losses arising from the emergence of additional nonperforming loans.

Under our forecast, we assume:

- Lending growth of about 10% per year over the next two years, driven by a gradual recovery in the UAE economy and NBF's smaller base compared with peers.
- A stable net interest margin, as cost of funding stabilizes.
- A gradual improvement in asset quality, as the bank continues to grow its loan book more cautiously.
- A cash-dividend payout ratio of about 20% for the next 12-24 months.

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

Table 3

National Bank of Fujairah PJSC Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Tier 1 capital ratio	14.7	14.1	15.1	15.2	15.7
S&P Global Ratings' RAC ratio before diversification	N/A	11.6	12.0	12.8	13.1
S&P Global Ratings' RAC ratio after diversification	N/A	8.5	8.6	10.2	11.1
Adjusted common equity/total adjusted capital	89.9	89.5	79.1	77.7	76.1
Net interest income/operating revenues	67.5	69.0	66.6	64.3	66.1
Fee income/operating revenue	20.7	19.6	22.6	23.6	24.2
Market-sensitive income/operating revenue	10.7	8.4	8.7	8.6	7.7
Noninterest expenses/operating revenues	31.4	33.2	33.7	34.4	36.8
Preprovision operating income/average assets	2.9	2.8	2.5	2.6	2.8
Core earnings/average managed assets	1.7	1.6	1.3	1.4	2.0

*Data as of March 31. N/A--Not applicable.

Table 4

National Bank Of Fujairah PJSC Risk-Adjusted Capital Framework Data

(Mil. AED)	EAD	Basel III RWA	Average Basel III RW (%)	S&P Global RWA	Average S&P Global RW (%)
Credit risk					
Government and central banks	7,887	--	--	204	3
Of which regional governments and local authorities†	222	--	--	8	4
Institutions and CCPs	3,145	--	--	1,195	38
Corporate	31,872	--	--	31,631	99
Retail	2,998	--	--	1,982	66
Of which mortgage	1,877	--	--	863	46
Securitization*	--	--	--	--	--
Other assets§	1,398	--	--	2,122	152
Total credit risk	47,300	--	--	37,133	79
Credit valuation adjustment					
Total credit valuation adjustment	--	--	--	--	--
Market risk					
Equity in the banking book	111	--	--	991	889
Trading book market risk	--	67	--	100	--
Total market risk	--	67	--	1,091	--
Operational risk					
Total operational risk	--	--	--	2,951	--
Diversification adjustments					
RWA before diversification	--	--	--	41,075	100
Total diversification/concentration adjustments	--	--	--	15,373	37
RWA after diversification	--	--	--	56,448	137
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		4,732	14.1	4,760	11.6
Capital ratio after adjustments‡		4,732	14.1	4,760	8.5

*Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. §Other assets includes Deferred Tax Assets (DTAs) not deducted from ACE. †For public-sector funding agencies, the single name adjustment is calculated on the regional government and local authority's portfolio. ‡For Tier 1 ratio, adjustments are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). AED--United Arab Emirates dirham. EAD--Exposure At Default. RWA--Risk-Weighted Assets.

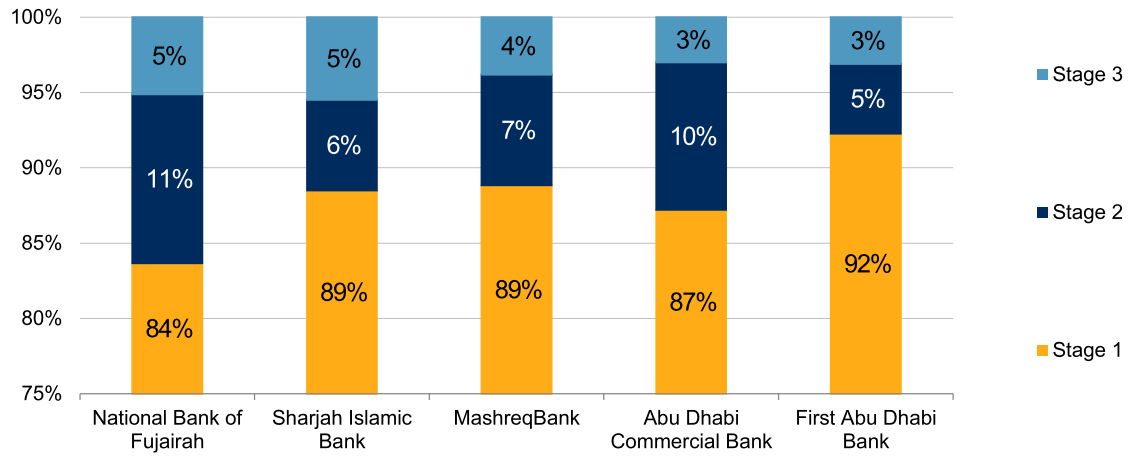
Risk position: Improving asset quality indicators, with adequate loan loss coverage

Thanks to its cautious strategy and conservative underwriting standards over the past couple of years, NBF's ratio of Stage 3 loans—under the International Financial Reporting Standards (IFRS) 9 nonperforming book--to total loans improved to 5.2% at March-end 2019, from 5.5% at year-end 2017. In addition, loan-loss provisions coverage of Stage 3 loans, including impairment reserves of AED266.4 million, strengthened to 102% as of March 31, 2019, from 89.5% at year-end 2017. Although the bank displayed improved asset-quality indicators, a substantial amount of problematic loans remain on its balance sheet, mostly from legacy client relationships. Nevertheless, we expect the asset-quality

indicators to gradually improve over the next 12-24 months as the bank continues to clean its legacy portfolio and lend more cautiously, with tightened underwriting standards.

Chart 3

UAE Rated Banks' Loan Portfolio Distribution By IFRS 9 Stage



IFRS--International Financial Reporting Standards. Source: S&P Global Ratings.

Because NBF is a niche player in trade finance, the bank operates with lower single-party concentrations than its peers, with the top-20 funded exposures accounting for about 24.3% of gross loans at year-end 2018. Similar to its peers, NBF exhibits high real estate and construction exposures. At year-end 2018, loans to these sectors comprised about 19.1% of the loan book, compared with a UAE banking industry average of about 20%.

Table 5

National Bank of Fujairah PJSC Risk Position

		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Growth in customer loans§	0.8	8.1	5.4	15.8	20.2
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	36.3	39.2	25.7	18.3
Total managed assets/adjusted common equity (x)	9.0	9.3	9.7	10.2	9.5
New loan loss provisions/average customer loans	1.7	1.6	1.8	1.8	1.1
Net charge-offs/average customer loans	0.7	2.5	1.6	1.1	0.4
Gross nonperforming assets/customer loans + other real estate owned	5.2	5.1	5.5	5.0	4.7
Loan loss reserves/gross nonperforming assets including impairment reserves	101.6	102.0	89.5	101.1	107.7

*Data as of March 31, 2019. §Growth in customer loans figures are annualized for 2019. RWA--Risk-weighted assets. N/A--Not applicable.

Funding and liquidity: Healthy funding and liquidity metrics

NBF's funding profile is in line with its domestic peers'. The bank funds itself predominantly from domestic customer deposits. NBF's loan-to-deposit ratio stood at 87% and the ratio of stable funding resources to funding needs was a

healthy 113%, as of March 31, 2019, according to our calculations. Like most banks in the GCC, NBF exhibits funding concentrations. Its ratio of top-20 depositors to total deposits remained high at 42% at year-end 2018 and is dominated by NBF's shareholders and affiliated entities.

The bank has a relatively liquid balance sheet. As of March 31, 2019, 19.2% of its assets comprised cash and money market instruments, while another 8.4% came from the securities portfolio, largely composed of highly rated government, quasi-government, and financial institution bonds. Broad liquid assets covered short-term wholesale funding needs by 8.7x and net broad liquid assets covered 26.4% of short-term customer deposits as of year-end 2018. The short-term nature of the bank's balance sheet mitigates the liquidity risk.

Table 6

National Bank of Fujairah PJSC Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Core deposits/funding base	94.4	95.5	93.2	89.6	89.2
Customer loans (net)/customer deposits	86.7	86.0	86.4	88.0	91.1
Long-term funding ratio	96.9	97.4	96.1	94.0	93.8
Stable funding ratio	112.8	114.4	119.0	116.7	116.0
Short-term wholesale funding/funding base	3.6	3.1	4.5	6.9	7.3
Broad liquid assets/short-term wholesale funding (x)	N/A	8.7	6.6	4.4	4.1
Net broad liquid assets/short-term customer deposits	N/A	26.4	27.9	28.4	27.7
Short-term wholesale funding/total wholesale funding	N/A	50.4	44.2	50.1	48.8
Narrow liquid assets/3-month wholesale funding (x)	7.0	10.5	8.9	4.8	5.3

*Data as of March 31. N/A--Not applicable.

Support: Moderate systemic importance in a highly supportive country

The long-term rating on NBF is two notches higher than the stand-alone credit profile, given our view of the bank's moderately high systemic importance in the UAE. NBF is a mid-tier bank—the 14th largest among the UAE's 49 banks--with a lending market share of about 1.7%. The five largest institutions dominate the UAE banking system and control more than 65% of the market. The assessment also reflects the government of Fujairah's direct and indirect stake in NBF (40.67% directly and 5.1% through the Fujairah Investment Company), combined with the government of Dubai's stake (8.74% through the Investment Corporation of Dubai). We also consider the UAE authorities to be highly supportive toward their banking system, with a strong track record of support provision.

Ratings above the sovereign

We apply the sovereign stress test for NBF at the UAE level and not at the level of Dubai, where the bank has material exposure. This is because we view the UAE as the relevant level of jurisdiction for banks (see "Guidance: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions," Feb. 13, 2019).

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

- Criteria | Financial Institutions | Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment: United Arab Emirates, April 17, 2019
- Guidance: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Feb. 13, 2019
- Dubai Real Estate Downturn To Continue: Projections And Ratings Impact, Feb. 26, 2019

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 29, 2019)*

National Bank of Fujairah PJSC	
Issuer Credit Rating	BBB+/Stable/A-2
Issuer Credit Ratings History	
31-Mar-2014	BBB+/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable

Ratings Detail (As Of May 29, 2019)*(cont.)

across countries. S&P Global Ratings' 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.