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National Bank of Fujairah PJSC

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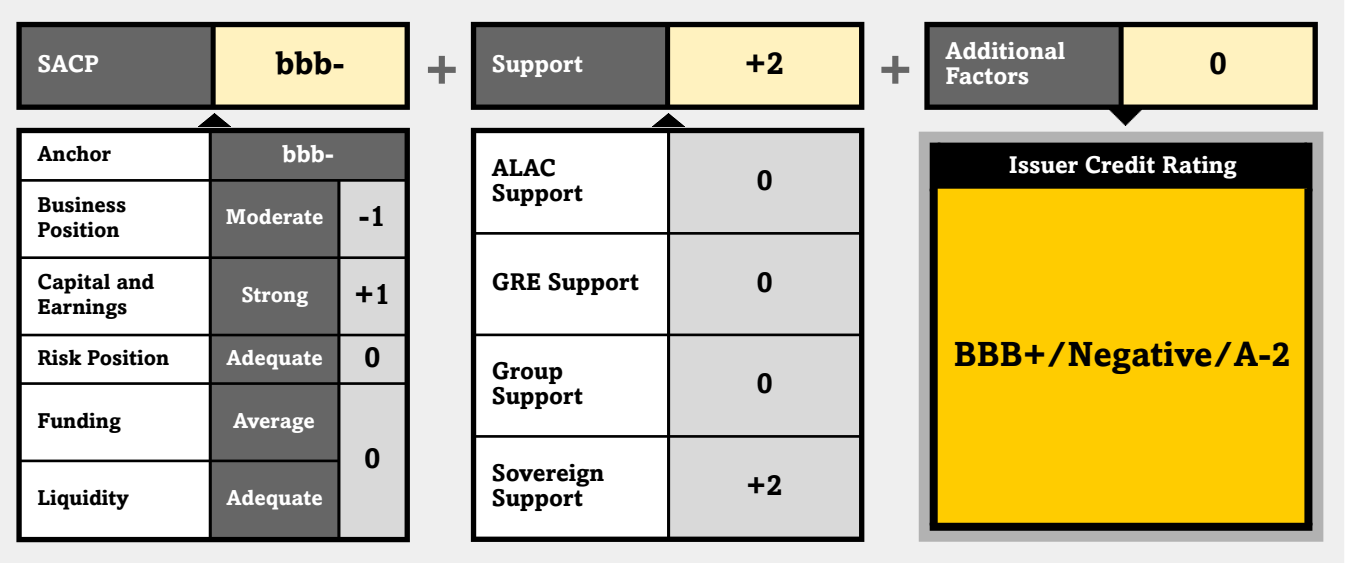
National Bank of Fujairah PJSC



Major Rating Factors

Strengths:	Weaknesses:
• Strong capital buffers. • A well-established niche franchise. • Stable management team.	• Expected deterioration in asset quality indicators due to significant exposure to sectors vulnerable to COVID-19. • Limited geographic diversification. • High concentration risk on both sides of the balance sheet.

Outlook: Negative

The negative outlook on National Bank of Fujairah PJSC (NBF) reflects our view that the worsening operating environment could result in a significant deterioration of the bank's asset quality indicators and hamper its profitability.

We could lower the ratings in the next 12-24 months if pressure on the bank's operating environment intensifies or if we observe a significant increase in problem loans (stage 2 and stage 3).

We could revise the outlook to stable in the next 12-24 months if risks related to the operating environment recede, NBF's asset quality deterioration does not exceed our expectation, and capitalization remains strong.

Rationale

Against the backdrop of a less supportive economic environment, we expect NBF's asset quality to deteriorate in 2020, spurred by substantial exposure to trade, real estate, and services sectors. While NBF has a well-established position in the corporate middle market, its core business is smaller and riskier compared with local and regional peers. We expect the United Arab Emirates (UAE) economy to shrink by around 8% in 2020, followed by a mild recovery in 2021. As of March 31, 2020, NBF's stock of problematic loans (stage 2 and stage 3 loans) started to weaken, reaching 16.4% of gross loans compared with 14.6% at year-end 2019. We expect this trend to continue, with the ratio of problematic loans to gross loans increasing to about 20% over the next 12-24 months. However, the bank's strong capitalization provides it with a good buffer against these risks, in our opinion. In the current environment, we do not rule out a scenario where NBF will be loss-making in 2020, but such an outcome can be accommodated within the bank's overall financial position. We still expect its risk-adjusted capital (RAC) ratio to decline to around 11.5%-12.5% over the next 12-24, months compared with 12.6% at year-end 2019. NBF's funding and liquidity profile is comparable with local peers and benefits to some extent from a large noninterest bearing deposit base and expected support from the UAE Central Bank (CBUAE) in case of need. We view NBF's systemic importance in the UAE as moderately high, and we regard the UAE as highly supportive of the domestic banking sector. Therefore, we incorporate two notches of uplift from the bank's intrinsic creditworthiness in our final rating.

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

Our starting point for the rating of a commercial bank operating in the UAE is 'bbb-'.

The UAE has a wealthy economy with strong fiscal and external positions. The strength of the government's net asset position has helped counteract the negative impact of lower oil prices on economic growth since late 2015. However, we believe the dual shock of the sharp drop in oil prices and lower economic activity due to COVID-19 will lead to a rise in problem loans and the cost of risk for banks in the UAE in the next 12-24 months. Although UAE banks traditionally operate with healthy profitability metrics, the shift in U.S. Federal Reserve monetary policy toward a more accommodative stance will have negative consequences for banks' margins. In addition, we expect credit losses to increase in 2020-2021, leading to a slump in sector profitability.

Although, we view favorably the CBUAE's recently announced Targeted Economic Support Scheme (TESS), which should help to ease the pressure on corporate issuers and small and midsize enterprises, it does not reduce credit risk from the banking system's balance sheet. We also note the relaxation of certain prudential requirements, for example, the cap on real estate exposures and the increase in loan-to-value limits for mortgage lending, and we see some potential risks of lower recognition and disclosure of problematic assets. Public-sector and government depositors provide more than 25% of resident deposits. We expect these entities to withdraw some deposits from the banking system in 2020. However, we do not see any immediate liquidity challenges for the banking sector thanks to proactive measures by the CBUAE to support liquidity in the system, including TESS, reduction in the regulatory capital conservation buffers (CCB), and the relaxation of liquidity buffers for banks.

Table 1

National Bank of Fujairah PJSC--Key Figures

	--Year ended Dec. 31--				
(Mil. AED)	**2020***	**2019**	**2018**	**2017**	**2016**
Adjusted assets	41,560	40,846	37,757	35,267	34,009
Customer loans (gross)	28,619	28,389	27,367	25,320	24,023
Adjusted common equity	4,517	4,486	4,260	3,792	3,493
Operating revenues	417	1,708	1,574	1,379	1,319
Noninterest expenses	124	563	522	465	453
Core earnings	75	552	615	472	460

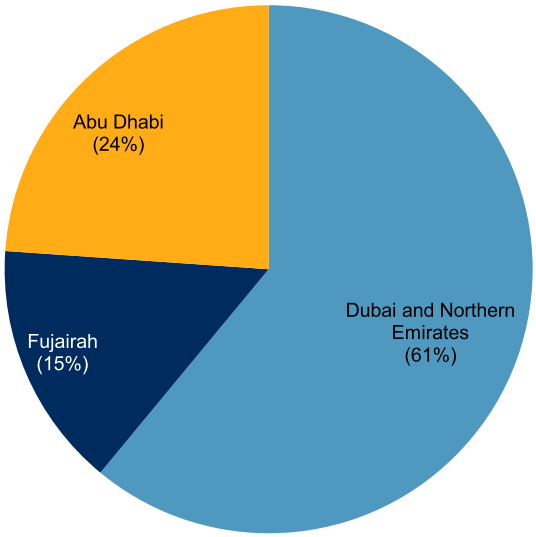
*Data as of March 31. AED--UAE dirham.

Business position: Small and niche commercial franchise

We think NBF benefits from its well-established position in the corporate middle market. With assets totaling UAE dirham (AED) 43.2 billion on March 31, 2020, NBF has a market share of about 1.6% in lending and 1.7% 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 6% as of Dec. 31, 2019.

Chart 1

Breakdown Of Advances By Emirates



Source: S&P Global Ratings.

We consider NBF's pre-provision earnings to be predictable because most revenue is generated from net-interest income.

The bank has been diversifying into Sharia-compliant banking services, which represented 7.4% of the overall operating income for the year ended Dec. 31, 2019. After loan growth of around 12% average over the last four years prior to 2019, the bank's growth moderated in 2019 because of the slowdown in the non-oil economy, as well as management's decision to manage growth cautiously. We believe NBF, in line with other regional peers, will focus more on preserving asset quality than generating new business amid the COVID-19 pandemic.

NBF enjoys a close relationship with its major shareholder, the Government of Fujairah, which held 45.13% of NBF's share capital at year-end 2019, jointly through the Department of Industry and Economy and Fujairah Natural Resources Corporation. The Government of Dubai, which held 8.74% of NBF's issued share capital through the Investment Corporation of Dubai, is amongst the largest shareholders of NBF. 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--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Total revenues from business line (currency in millions)	417.5	1,708.1	1,573.8	1,378.5	1,319.1
Commercial banking/total revenues from business line	70.3	72.7	75.4	75.0	74.1
Retail banking/total revenues from business line	7.8	8.1	8.7	8.2	7.6
Commercial & retail banking/total revenues from business line	78.1	80.8	84.1	83.2	81.7
Trading and sales income/total revenues from business line	21.9	19.2	15.9	16.8	18.3
Return on average common equity	6.1	11.4	14.5	12.6	13.4

*Data as of March 31.

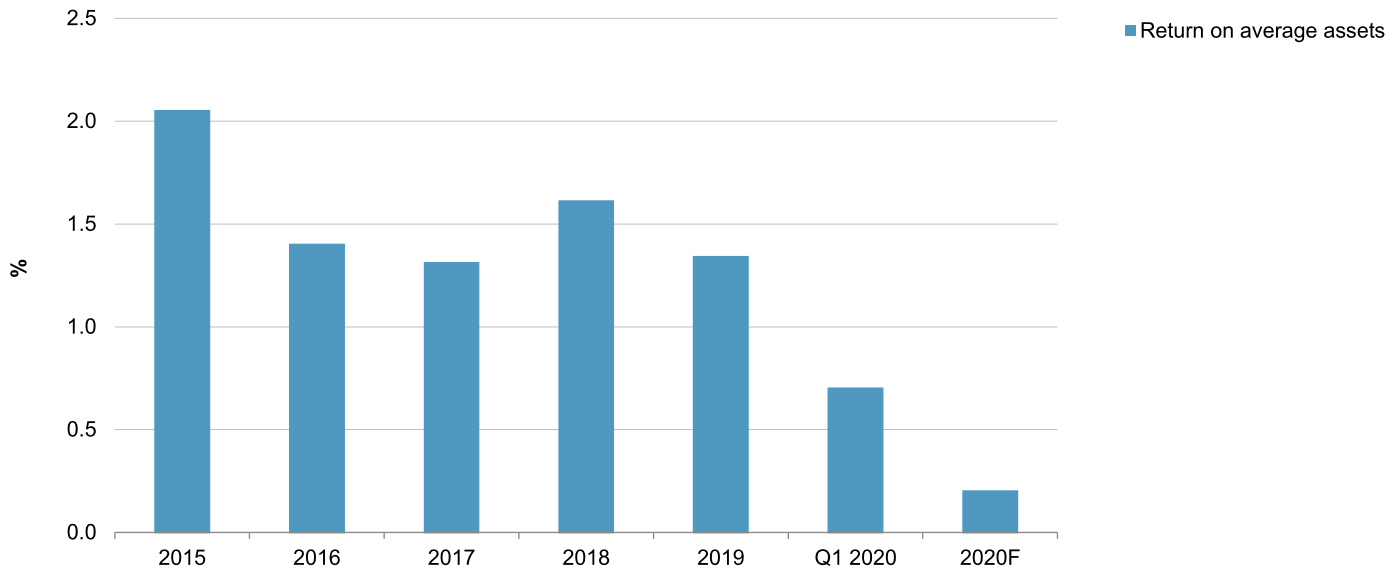
Capital and earnings: Expected to remain strong

Our assessment of NBF's capital and earnings reflects the bank's strong level of capitalization. We forecast our RAC ratio for the bank at 11.5%-12.5% over the next 12-24 months, compared with 12.6% at year-end 2019. NBF strengthened the capital structure by raising $350 million through the issuance of an additional Tier 1 (AT1) instrument in October 2019. The bank's regulatory capital ratio and Tier 1 ratio reached 17.3% and 16.2% respectively at March 31, 2020, well above minimum capital requirements.

NBF's profitability reduced in 2019 and Q1 2020, with return on average assets declining to 0.7% in Q1 2020, from 1.3% in 2019 and 1.6% in 2018, underpinned by higher credit losses. While this is not our base-case scenario, we don't exclude a scenario where the bank posts losses in 2020. We also believe the pre-provision earnings and profitability will decline substantially in 2020-2021, owing to lower interest rates and substantial increase in credit losses.

Chart 2

We Expect Profitability To Decline Substantially



F--Forecast. Source: S&P Global Ratings.

Our forecasts for NBF over the next 12-24 months incorporate the following assumptions:

- Lending growth of low-single digits per year over the next two years, driven by a weakness in the UAE economy and lower demand from private sector corporates.
- Net interest margin to decline by 50 basis points (bps)-60bps in the low interest rate environment.
- Credit losses to increase to about 350bps over the next two years.

Based on our calculations, NBF's three-year average earnings buffer stands at about 1.7%, which indicates 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--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	16.2	16.6	14.1	15.1	15.2
S&P Global Ratings' RAC ratio before diversification	N/A	12.6	11.6	12.0	12.8
S&P Global Ratings' RAC ratio after diversification	N/A	9.4	8.5	8.6	10.2
Adjusted common equity/total adjusted capital	77.8	77.7	89.5	79.1	77.7
Net interest income/operating revenues	66.2	67.5	69.0	66.6	64.3
Fee income/operating revenues	18.3	20.0	19.6	22.6	23.6

Table 3

National Bank of Fujairah PJSC--Capital And Earnings (cont.)

	--Year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Market-sensitive income/operating revenues	12.4	9.5	8.4	8.7	8.6
Noninterest expenses/operating revenues	29.7	33.0	33.2	33.7	34.4
Preprovision operating income/average assets	2.7	2.8	2.8	2.5	2.6
Core earnings/average managed assets	0.7	1.3	1.6	1.3	1.4

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

Table 4

National Bank of Fujairah PJSC--Risk-Adjusted Capital Framework Data

(Mil. AED)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Credit risk					
Government and central banks	8,254.5	--	--	215.4	2.6
Of which regional governments and local authorities	130.0	--	--	4.7	3.6
Institutions and CCPs	4,161.4	--	--	1,649.1	39.6
Corporate	33,548.1	--	--	34,203.0	102.0
Retail	2,994.1	--	--	1,911.9	63.9
Of which mortgage	1,888.8	--	--	883.2	46.8
Other assets†	2,311.0	--	--	3,527.4	152.6
Total credit risk	51,269.0	--	--	41,506.8	81.0
Market Risk					
Equity in the banking book	109.2	--	--	955.6	875.0
Trading book market risk	--	41.6	--	93.6	--
Total market risk	--	41.6	--	1,049.2	--
Operational risk					
Total operational risk	--	--	--	3,202.7	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	41.6	--	45,758.6	100.0
Total diversification/ Concentration adjustments	--	--	--	15,603.9	34.1
RWA after diversification	--	41.6	--	61,362.5	134.1
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		5,785.2	16.6	5,771.1	12.6
Capital ratio after adjustments‡		5,785.2	16.6	5,771.1	9.4

Table 4

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

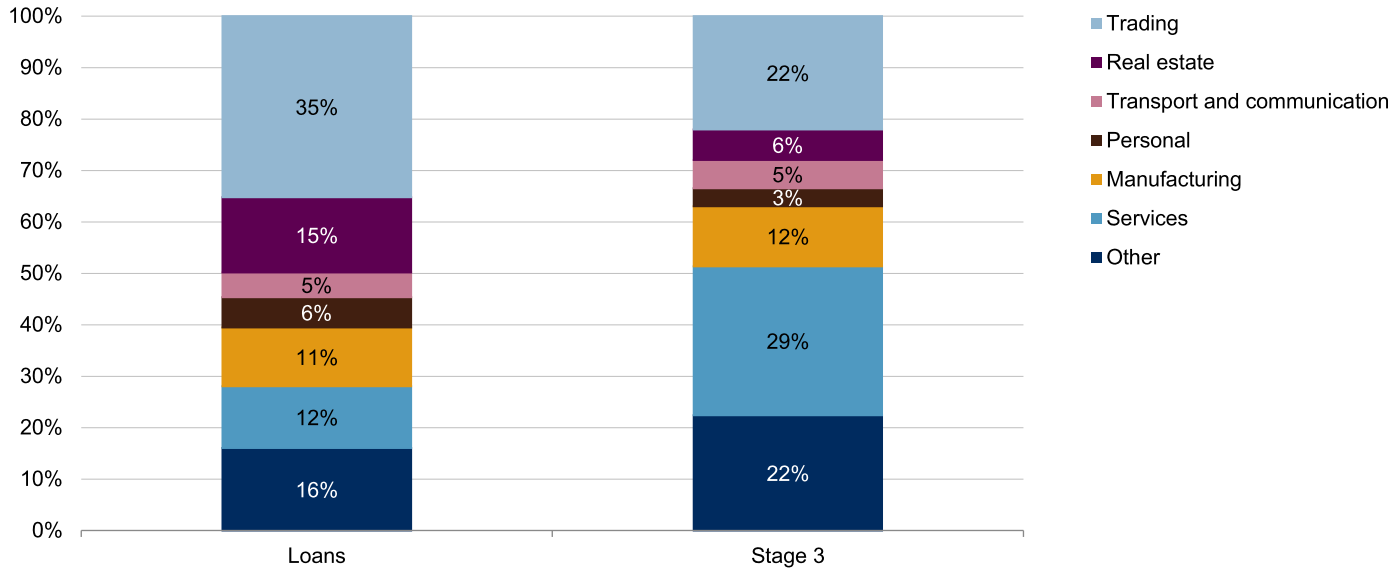
*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 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 2019', S&P Global Ratings.

Risk position: We expect problem exposures to increase

As a result of the economic shock induced by COVID-19 and the oil price drop, we expect NBF's asset quality to deteriorate in 2020-2021, spurred by substantial exposure to the impacted sectors, such as services, trade, and real estate, and weaker franchise compared with more established and larger local peers. NBF's stock of Stage 3 loans as a share of total loans increased to 6.7% in Q1 2020, from 5.4% at year-end 2019, and 5.1% at year-end 2018, and cost of risk increased to 305bps in Q1 2020, from 212bps in 2019, and 165bps in 2018. This is mainly because of provisions for a single group exposure as Stage 3 in Q1 2020. In addition, the bank had 9.7% loans in Stage 2 at the of end Q1 2020. Loan-loss provisions coverage of Stage 3 loans, including impairment reserves of AED407 million, declined to 96% on March 31, 2020, from 102% at year-end 2018. We expect the ratio of Stage 3 to total loans will increase to 8%-10%, while the bank's stock of problematic loans (Stage 2 + Stage 3) will increase to around 20% over the next 12-24 months, depending on when NBF recognizes the full extent of the asset-quality problem. We expect the cost of risk to increase and stabilize at around 350bps over the next 12-24 months.

Chart 3

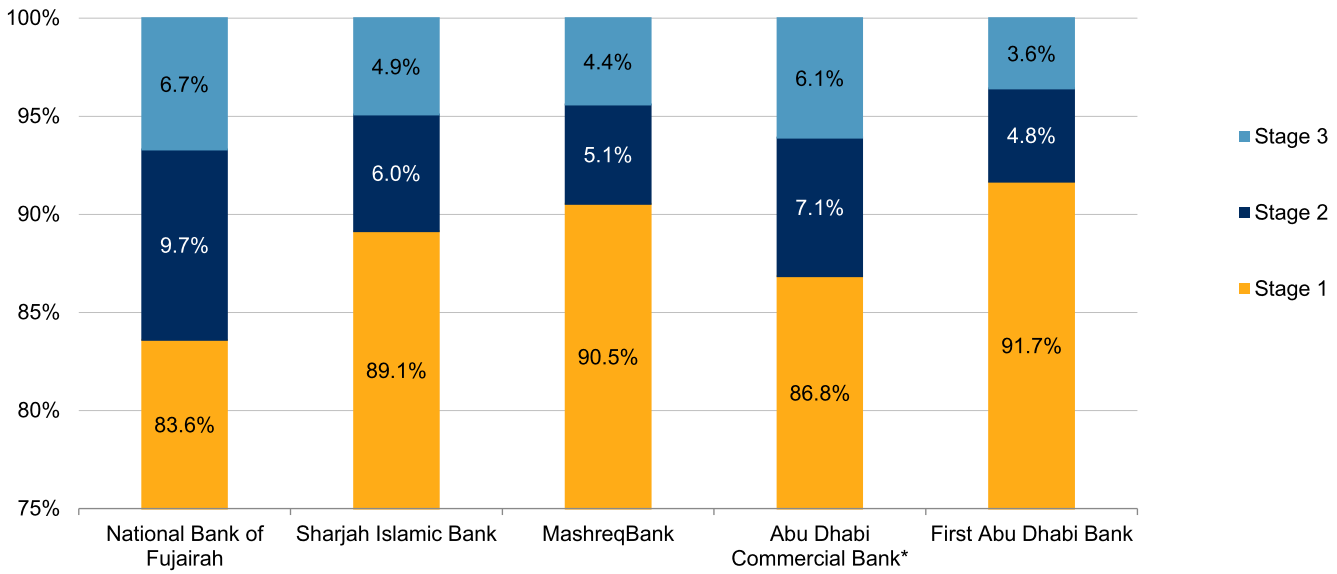
Loan Book Split As Of End-Q1 2020



Source: S&P Global Ratings.

Chart 4

UAE Rated Banks Loan Portfolio Distribution By IFRS 9
As of March 31, 2020



Source: S&P Global Ratings. *Stage 2 Loans data as of December 2019.

Similar to other Gulf Cooperation Council (GCC) banks, another key source of risk for NBF lies in high single-party concentration. The 20-largest funded and unfunded corporate gross credit exposures represent 24.0% of the bank's loan book and unfunded exposure at year-end 2019. Similar to its peers, NBF exhibits high real estate and construction exposures. At March 31, 2020, loans to these sectors comprised about 22% of the loan book, compared with a UAE banking industry average of about 20%. In addition, exposure to the trading sector comprised around 35% of the loan book, which we think will be negatively impacted because of COVID-19.

Table 5

National Bank of Fujairah PJSC--Risk Position

	--Year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Growth in customer loans§	3.2	3.7	8.1	5.4	15.8
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	34.1	36.3	39.2	25.7
Total managed assets/adjusted common equity (x)	9.6	9.5	9.3	9.7	10.2
New loan loss provisions/average customer loans	3.1	2.1	1.6	1.8	1.8
Net charge-offs/average customer loans	0.6	1.5	2.5	1.6	1.1
Gross nonperforming assets/customer loans + other real estate owned	6.7	5.4	5.1	5.5	5.0
Loan loss reserves/gross nonperforming assets including impairment reserves	96.3	107.3	102.0	89.5	101.0

*Data as of March 31. §2020 figures are annualized. N/A--Not applicable. RWA--Risk-weighted assets.

Funding and liquidity: In line with domestic peers

NBF's funding profile is in line with domestic peers'. The bank funds itself predominantly from domestic customer deposits. NBF's loan-to-deposit ratio stood at 85% and the stable funding ratio was a healthy 116%, as of March 31, 2020, 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 38% at year-end 2019, and is dominated by NBF's shareholders and affiliated entities.

The bank has a relatively liquid balance sheet. As of March 31, 2020, 23% of its assets comprised cash and money market instruments, while another 7% 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 4.8x and net broad liquid assets covered 27% of short-term customer deposits as of March 31, 2020. We believe 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--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Core deposits/funding base	93.5	95.1	95.5	93.2	89.6
Customer loans (net)/customer deposits	84.9	84.8	86.0	86.4	88.0
Long-term funding ratio	94.7	95.9	97.4	96.1	94.0
Stable funding ratio	116.2	115.5	114.4	119.0	116.7
Short-term wholesale funding/funding base	6.2	4.9	3.1	4.5	6.9
Broad liquid assets/short-term wholesale funding (x)	4.8	6.0	8.7	6.6	4.4
Net broad liquid assets/short-term customer deposits	27.0	27.2	26.4	27.9	28.4
Short-term wholesale funding/total wholesale funding	60.6	56.1	50.4	44.2	50.1
Narrow liquid assets/3-month wholesale funding (x)	6.1	6.4	10.5	8.9	4.8

*Data as of March 31.

External 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 with a lending market share of about 1.6%. The five largest institutions dominate the UAE banking system and control about 75% of the market. The assessment also reflects the government of Fujairah's direct and indirect stake in NBF (40.86% 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.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- 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: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment 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, May 20, 2020
- Outlooks On Five UAE Banks Revised To Negative On Deteriorating Operating Environment, March 26, 2020

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 July 2, 2020)*

National Bank of Fujairah PJSC	
Issuer Credit Rating	BBB+/Negative/A-2
Issuer Credit Ratings History	
26-Mar-2020	BBB+/Negative/A-2
31-Mar-2014	BBB+/Stable/A-2
Sovereign Rating	
Ras Al Khaimah (Emirate of)	A/Negative/A-1

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