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National Bank of Fujairah – Ratings Affirmed with a Stable Outlook

Capital Intelligence Ratings (CI Ratings or CI) today announced that it has affirmed the Long-Term Foreign Currency Rating (LT FCR) and Short-Term Foreign Currency Rating (ST FCR) of National Bank of Fujairah (NBF) at 'A-' and 'A2', respectively. At the same time, CI Ratings has affirmed NBF's Bank Standalone Rating (BSR) of 'bbb', Core Financial Strength (CFS) rating of 'bbb', and Extraordinary Support Level (ESL) of High. The Outlook for the LT FCR and BSR is Stable.

The LT FCR is set two notches above the BSR to reflect the Bank's ESL of High. CI expects the Bank to receive support from the UAE government (sovereign ratings: 'AA-'/'A1+'/Stable) in case of need. The government has demonstrated such support in the past and, in CI's view, has the means and the willingness to continue to do so in the future. The Bank can also expect support from the government of Fujairah.

NBF's BSR is derived from a CFS rating of 'bbb' and an Operating Environment Risk Anchor (OPERA) of 'bbb'. The CFS is underpinned by the Bank's strong capital ratios, improving asset quality, good and rising operating profitability and ROAA, and comfortable liquidity. The principal challenges are customer concentrations in loans and deposits (in common with peers) and sector concentration in trade finance, along with continuing high provisioning expenses. Other challenges are the slow growth of the global economy and elevated geopolitical risks in the region, although the UAE is doing well on the back of favourable oil prices.

The OPERA assessment reflects the UAE's continuing dependence on hydrocarbons, although less so than neighbouring countries, with the economic risk partially mitigated by the support of the wealthy emirate of Abu Dhabi. The UAE banking sector remained strong in 2023, fuelled by improving macroeconomic performance and high hydrocarbon prices. The banking system is sound with high levels of capitalisation, improving profitability and asset quality, and adequate liquidity.

As a mainly corporate banking institution, NBF has a less diversified business base than its larger competitors and is essentially focused on the UAE economy, making it more vulnerable to downturns. However, it offers a wide range of corporate products and services and has built franchise strength in a few areas such as trade finance, precious metals, and foreign exchange. While the loan portfolio has some concentration in the trade sector, we believe that the Bank's well-established reputation and strong product offering in this segment, along with its good risk standards and the short tenor of credits, are mitigating factors. Customer concentration in loans and advances remains high, in common with the sector, due to the nature of the market which is dominated by a small number of large corporate groups and government-related entities.

Asset quality metrics have strengthened over the years. NPLs have declined (although Q1 24 saw a small uptick in impairments), reflecting the improving credit climate and good recoveries. The decrease in the NPL ratio was driven primarily by write-offs and partially by the effect of growth in loans and Islamic financings. The NPL ratio is presently marginally better than the sector median. With past dues at a moderately low level across all portfolios we could see further improvements by year-end. The Stage 2 loans to gross loans ratio was a moderate 7% in 2023 – on par with other banks of similar size.

The loan-loss reserve coverage ratio has increased over the last few years and was above 100% for the second consecutive year at end-2023. The ratio is also higher than the sector median. Since the central bank is keen for banks to fully discount the value of collateral over a period of time (new standards are in the process of being issued) we expect provisions to rise further. The capital buffer against future asset quality shocks is improving and is presently at a moderately good level. The annual credit risk charge remains high, despite declining, partly due to write-offs and building of general provisions. However, these are more than offset by the successive improvements in operating profitability. We expect provisioning expenses to decline gradually to more normal levels as asset quality pressures continue to ease. If high interest rates persist over an extended period, this could put some pressure on the quality of the SME book; however, NBF's sound risk standards and understanding of the SME market provide safeguards.

NBF's key profitability ratios continued to strengthen in 2023 and Q1 24 on the back of growth in lending and investments, good margins and cost efficiencies. The Bank's operating profitability ratio continues to be better than the average for CI-rated banks, reflecting its sound income generation capabilities. NBF has a long track record of generating high net interest income and non-interest income even during difficult periods, which has enabled it to set aside sizeable provisions over the last few years. NBF's focus on business expansion and rapid digitisation along with CASA strategies aimed at growing low-cost funds are expected to strengthen its foundations and help withstand the impact of a possible moderation in interest rate hikes later this year or next. We expect the Bank's operating profitability ratio to continue to be good. Provisioning expenses have been high (above the average for small and mid-sized banks); nevertheless, ROAA has increased in line with the growth in operating income. We expect provision charges to fall over the next few years, and the Bank's 2024 ROAA is likely to show an improvement over the previous year.

Liquidity ratios are comfortable and key ratios continued to strengthen on the back of good growth in customer deposits and rising liquid assets. The Bank relies mainly on customer deposits for funding but as a small/mid-sized bank with a limited retail franchise, it is dependent on corporate deposits leading to a high level of customer concentration. The latter is a common feature of the UAE banking sector. Major depositors include related-party entities, which have provided stable funding for decades and even during stressed liquidity conditions in the banking system. NBF has a reasonably good level of CASA for a bank of its size. We do not expect any major changes in the Bank's current overall funding profile.

Capital ratios have been good over the last several years. Key ratios improved marginally last year and are well above the regulatory minima with a good buffer. Capital metrics are also better than the peer median ratios. The Bank paid a cash dividend in respect of 2023 net profit; between 2020 and 2022 no cash dividends were paid, with management prioritising the building of general provisions over dividend distribution. We expect capital ratios to remain high over the next 12 months. NBF's supportive shareholders would be able and willing to provide additional capital if necessary. The Bank has the shareholders' approval to issue USD275mn AT1 bonds to the government of Fujairah in September this year which, subject to regulatory approvals, would be converted into shares within two years, potentially raising CET 1 capital.

Rating Outlook

The Stable Outlook on the LT FCR and the BSR indicates a better than even chance that the ratings are unlikely to change over the next 12 months. We expect key financial parameters to be maintained at least at current levels.

Rating Dynamics: Upside Scenario

A Positive Outlook or a one-notch upgrade in the LT FCR and BSR over the next 12 months would require a sustained improvement in the Bank's standalone profile.

Rating Dynamics: Downside Scenario

Though unlikely, the Outlook could be revised to Negative or the LT FCR and BSR downgraded by one notch if the Bank's credit profile deteriorates substantially. This could be caused by a significant weakening of asset quality or profitability that the Bank may not be able to correct in a reasonable period of time.

Ratings

Foreign Currency		Outlook	BSR	Outlook	CFS	ESL	OPERA
LT	ST	LT FC		BSR			
A-	A2	Stable	bbb	Stable	bbb	High	bbb

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About the Ratings

The credit ratings have been issued by Capital Intelligence Ratings Ltd, P.O. Box 53585, Limassol 3303, Cyprus.

The following information sources were used to prepare the credit ratings: public information and information provided by the rated entity. Financial data and metrics have been derived by CI from the rated entity's financial statements for FY2019-23. CI may also have relied upon non-public financial information provided by the rated entity and may also have used financial information from credible, independent third-party data providers. CI considers the quality of information available on the rated entity to be satisfactory for the purposes of assigning and maintaining credit ratings. CI does not audit or independently verify information received during the rating process.

The principal methodology used to determine the ratings is the Bank Rating Methodology, dated 3 April 2019 (see www.ciratings.com/page/rating-methodologies/bank-ratings). Information on rating scales and definitions, the time horizon of rating outlooks, and the definition of default can be found at www.ciratings.com/page/our-policies-procedures. Historical performance data, including default rates, are available from a central repository established by ESMA (CEREP) at http://cerep.esma.europa.eu

This rating action follows a scheduled periodic (annual) review of the rated entity. Ratings on the entity were first released in July 1994. The ratings were last updated in August 2022. The ratings and rating outlook were disclosed to the rated entity prior to publication and were not amended following that disclosure.

The ratings have been initiated by CI. The following scheme is therefore applicable in accordance with EU regulatory guidelines.

Unsolicited Credit Rating

With Rated Entity or Related Third Party Participation:	Yes
With Access to Internal Documents:	Yes
With Access to Management:	Yes

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