

Research Update:

National Bank of Fujairah PJSC Upgraded To 'BBB+' On Higher Government Support; Outlook Stable

June 9, 2023

Overview

- We view the United Arab Emirates (UAE)'s authorities as highly supportive toward their banking system and they have a strong track record of extending support to systemically relevant institutions, including small banks.
- Furthermore, we expect favorable macroeconomic conditions will continue to support the UAE's fiscal position, thereby strengthening its capacity to support banks.
- In our view, these factors increase the likelihood of government support to National Bank of Fujairah PJSC (NBF), if needed.
- We therefore raised the long-term rating on NBF to 'BBB+' from 'BBB' and affirmed the 'A-2' short-term rating.
- The stable outlook reflects our view that the bank's creditworthiness will continue to benefit from its strong capitalization, although the average credit quality of its portfolio will remain weaker than the system average.

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Rating Action

On June 9, 2023, S&P Global Ratings raised its long-term issuer credit rating to 'BBB+' from 'BBB' and affirmed its 'A-2' short-term rating on United Arab Emirates (UAE)-based National Bank of Fujairah PJSC (NBF). The outlook is stable.

Rationale

The UAE's authorities have a strong track record of supporting local banks and their capacity to do so has improved, in our view. Notwithstanding a potential slowdown in real growth, we expect favorable macroeconomic conditions to remain supportive of the government's fiscal position (Abu Dhabi contributes the largest proportion to the UAE's federal budget) including its capacity to support banks, if needed. Although developing, the local capital market remains relatively small, and we expect the banking system will continue to play a very important role in the financing of the

economy. We therefore now incorporate a higher level of support from the UAE authorities in our rating on NBF, adding three notches--from two previously--above the stand-alone credit profile (SACP). This reflects the bank's moderate systemic importance, the government's highly supportive stance toward banks, and the potential for additional government support, if needed.

Although structural vulnerabilities persist, numerous management actions are helping to stabilize NBF's risks. NBF's total assets stood at \$11 billion at March 31, 2023, or about 1.4% of system assets. Nearly 70% of the bank's lending takes place in Dubai and the Northern Emirates. We continue to expect that NBF's small size and limited market share will create more visible risk exposures and earnings volatility than at larger UAE banks. NBF's strength as a niche, trade finance lender to specialized sectors such as diamonds, precious metals, marine, and engineering will likely provide healthy growth prospects over 2023 and 2024, but it also exposes the bank to smaller entities with greater structural vulnerability to macroeconomic downturns and cyclical risks. These risks are visible in NBF's longer-term credit loss metrics, which averaged 1.8% over 2016-2019 versus a system average of just under 1%. After a sharp increase in credit losses and nonperforming loans (NPLs) over 2020 because of the COVID-19 pandemic and a small number of large fraud cases, NPLs fell to 5.9% of total loans at March 31, 2023--in line with system levels--from over 10% in 2020. The bank's portfolio also remains concentrated, with the top-20 loans accounting for about 24% of total loans at March 31, 2023, although we note a slight decline in concentration compared with 2020.

We expect higher profitability to bolster capitalization. NBF posted record profits over 2022 and first-quarter 2023. Net interest margin growth to 4.25% at March 31, 2023, up 1.5% from year-end 2021, was mainly a result of positive gearing toward interest rates. Although still at very elevated levels--3.4% at March 31, 2023--we expect cost of risk will start to decline. This will help the bank's bottom line and, alongside contained cash dividends, support retained earnings and our measure of its ability to cover losses. As a result, we forecast our risk adjusted capital (RAC) ratio will strengthen toward 11.5% over 2024 from 10.7% at year-end 2022. Although funding costs will likely increase slightly due to migration toward time deposits, underlying loan growth is expected to be relatively strong versus system expectations. Underpinning our forecast is continued trade-finance demand and business stemming from developments in Fujairah's strategic energy infrastructure. The bank's deposit base is predominantly corporates, most of which are based in Fujairah, including public sector entities.

Outlook

The stable outlook reflects our view that the bank's creditworthiness will continue to benefit from its strong capitalization, although the average credit quality of its portfolio will remain weaker than the system average.

Downside scenario

We could lower the rating over the next 12-24 months if NBF's capitalization declines significantly, with the RAC ratio dropping and staying durably below 10%. This could happen because of weaker-than-expected profitability or higher dividend payouts. We could also take a negative rating action if we observe a sharper-than-expected deterioration of asset-quality indicators.

Upside scenario

An upgrade appears unlikely because it would require:

- A significant strengthening of NBF's franchise;
- A material reduction of risks in the bank's portfolio, leading for example to a cost of risk that would be comparable with peers; or
- A significant strengthening of the bank's capitalization, with the RAC ratio increasing sustainably above 15%.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-3

Governance factors are a moderately negative consideration in our credit rating analysis of NBF. The bank has significant trade-finance-related loan concentration and weaker asset-quality metrics than those of rated peers, which together indicate a moderately higher risk appetite. This weighs on our assessment of the bank's risk position.

We estimate that the bank has relatively limited direct lending to sectors exposed to energy transition risk, the indirect exposure (via the overall dependence of the UAE economy on hydrocarbons) is higher. Social risks are not materially different from those of its industry peers. Fujairah's authorities directly and indirectly own 46.75% of the bank, which helps NBF maintain key account relationships with the Fujairah government. We do not believe the ownership structure has resulted in any governance weakness and are not aware of any reputational controversies or noncompliance with laws and regulations that have led to legal or regulatory fines or settlements.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB+/Stable/A-2	BBB/Stable/A-2
SACP	bb+	bb+
Anchor	bbb-	bbb-
Business position	Moderate (-1)	Moderate (-1)
Capital and earnings	Strong (+1)	Strong (+1)
Risk position	Moderate (-1)	Moderate (-1)
Funding and liquidity	Adequate and Adequate (0)	Adequate and Adequate (0)
Comparable ratings analysis	0	0
Support	+2	+2
ALAC support	0	0
GRE support	0	0
Group support	0	0

	To	From
Issuer Credit Rating	BBB+/Stable/A-2	BBB/Stable/A-2
Sovereign support	+2	+2
Additional factors	+1	0

SACP--Stand-alone credit profile.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- UAE Banking Sector 2023 Outlook: Slower Growth, Strong Fundamentals, Jan. 30, 2023

Ratings List

Upgraded; Ratings Affirmed

	To	From
National Bank of Fujairah PJSC		
Issuer Credit Rating	BBB+/Stable/A-2	BBB/Stable/A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search

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