Credit Rating Announcement

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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 the 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 comfortable liquidity. The principal challenges are customer concentrations in loans and deposits (in common with peers) and sector concentration in trade finance, high provisioning expenses which continue to depress net profit and ROAA, although both are improving, and rising Stage 2 loans which are nevertheless at a moderate level. The slowing global economy due to high interest rates and monetary tightening by central banks is also a challenge, although the UAE economy is still doing well on the back of favourable oil prices.

The UAE's OPERA reflects the country'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. It also reflects the overall sound financial position of the banking sector.

As a corporate banking institution, NBF has a less diversified business base than its larger competitors who operate in all major customer segments. However, it offers a fairly wide range of corporate services and has built some 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 remain high, in common with the sector, due to the nature of the market which is dominated by a few large corporate groups and government-related entities. The Bank is essentially focused on the UAE economy, and to some extent on Dubai, and is therefore vulnerable to local cyclical developments.

The overall credit risk profile remains sound. The investment portfolio is well diversified with sizeable top-rated exposures. The quality of the credit portfolio continues to improve with NPLs declining steadily due to lower impairments (partly reflecting tighter underwriting standards) and some write-offs of fully provided bad loans, which are likely to be recovered since the exposures are collateralised. The NPL ratio is presently at a moderate level and is likely to fall further as gross loans rise and recoveries gather apace. The improving real estate market is also aiding the recovery process. Stage 2 loans have risen in recent periods but are still at a manageable level. However, we note that total loans under stress is still high.

NBF has made substantial provisioning expenses over the years, and its loan-loss reserve coverage ratio currently exceeds 100% and is better than the peer median ratio. Simultaneously, the capital buffer against future asset quality shocks is improving. Credit risk charges as a percentage of gross loans and operating profit are still high as the Bank continues to make general provisions. 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 its understanding of the SME market provides safeguards.

Profitability ratios strengthened in 2022 and in Q1 23, reflecting higher lending volumes, widening net interest margins (NIMs), good growth in non-interest income and falling cost to income ratios. Widening NIMs (due to rising interest rates) underpin the Bank's improving operating profitability, which is now better than the sector average. However, NBF's focus on business expansion and rapid digitisation along with CASA strategies aimed at growing low-cost funds would strengthen its foundations and help it to withstand the impact of a possible moderation in interest rate hikes later this year. While income growth rates would slow as interest rate hikes moderate, 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) and constrain the ROAA, which has nevertheless risen in line with growing income. We expect the Bank to take advantage of its continuing strong operating performance to make more general provisions, in line with its conservative outlook, but further improvements in ROAA are also likely.

Liquidity ratios continue to be maintained at very comfortable levels with customer deposits more than adequately funding credit expansion. The Bank also maintains a good level of liquid asset holdings. While customer deposits funded a sizeable portion of NBF's assets, as a small/mid-sized bank with a limited network and retail franchise, the Bank is dependent on corporate deposits leading to a high level of customer concentration, which is a common feature of UAE banking sector. Its major depositors, which include related-party entities, have provided stable funding for decades and even during stressed liquidity conditions in the banking system. The Bank has increased its CASA ratio over the last few years, which though lower than the ratios of the large banks, is on par with the average for small and mid-sized banks. The Bank's overall funding profile is not expected to change significantly going forward.

Capital ratios continue to be strong, despite a small decline in recent periods due to risk weighted assets (RWAs) growing faster than regulatory capital. Key ratios are on par with the sector median and well above the regulatory minima. Common equity, which accounts for a good portion of regulatory capital, is supplemented by Tier 1 bonds raised in 2019 and a small amount of Tier 2 capital in the form of general provisions. The Bank has not paid cash dividends since 2020, with management prioritising the building of general provisions over dividend distribution. However, shareholders received a small amount of bonus shares in Q1 23. We expect capital ratios to remain high over the next 12 months, despite potential small declines if RWAs continue to rise faster than capital. NBF's supportive shareholders would be able and willing to provide additional capital if necessary. The Bank has, in the past, reduced cash dividends to build its capital.

Rating Outlook

The Stable Outlook reflects our expectation that the ratings are unlikely to change over the next 12 months. We expect the Bank to be favourably impacted by the economic recovery that is currently underway.

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 significant strengthening of the Bank's standalone profile. Improvements that arise over the coming year in asset quality and profitability would essentially bring the Bank's key financial fundamentals in line with pre-Covid levels. A significant improvement over and above that level seems unlikely at this stage.

Rating Dynamics: Downside Scenario

Though unlikely, a Negative Outlook or a one-notch downgrade of the LT FCR and BSR would be made 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 FY2018-22 and Q1 2023. 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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