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National Bank of Fujairah PJSC

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Table Of Contents

Major Rating Factors

Outlook

Rationale

Related Criteria And Research

National Bank of Fujairah PJSC

SACP	bbb-	+	Support	+2	+	Additional Factors	0
Anchor	bbb-		GRE Support	0		Issuer Credit Rating BBB+/Stable/A-2	
Business Position	Moderate	-1					
Capital and Earnings	Strong	+1	Group Support	0			
Risk Position	Adequate	0					
Funding	Average	0	Sovereign Support	+2			
Liquidity	Adequate						

Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> Strong and improving capitalization. Healthy earnings generation and strong fee income. A well-established franchise as a niche player in trade finance and business banking in the United Arab Emirates (UAE). 	<ul style="list-style-type: none"> High depositor concentrations. Still-material level of restructured or renegotiated exposures. Limited geographic footprint.

Outlook: Stable

The stable outlook on the UAE-based National Bank of Fujairah PJSC (NBF) reflects Standard & Poor's Ratings Services' opinion that NBF's business and financial profiles will not change significantly over the next two years. We anticipate that NBF will remain a conservatively managed niche bank in the UAE's trade finance and business banking markets.

We would consider a positive rating action only if the bank's stand-alone credit profile (SACP) improved, such that we reassess it to 'bbb+' from 'bbb-'. However, we regard this as a remote possibility.

Although this is not included in our base case, we would consider a negative rating action if we considered that NBF's risk appetite had increased significantly, as shown by visibly higher-than-expected credit growth, or if we anticipated a significant rise in credit losses related to the bank's trade and receivables financing.

Rationale

The ratings on NBF factor in our 'bbb-' anchor for banks operating in the UAE and our view of the bank's "moderate" business position, "strong" capital and earnings, "adequate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms. We assess NBF's SACP at 'bbb-'.

The long-term rating on NBF is two notches higher than the SACP to incorporate our view of a "moderately high" likelihood that the UAE authorities would provide extraordinary support to NBF in the event of financial distress. We classify NBF as having "moderate" systemic importance and consider the authorities in the UAE to be "highly supportive" of the region's banking sectors.

Anchor: 'bbb-' for banks in the UAE

Our bank criteria 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'.

We view the UAE's economy and its high income levels as key strengths. On the other hand, the country's real estate prices have increased at a very fast pace over the past two years and we expect a degree of correction in 2015. In addition, although banks' reported asset quality metrics are strong and have been improving over the past few years, many banks are structurally exposed to high single-name concentrations and there is a fair level of restructured exposures in the system.

With regard to industry risk, we believe that the UAE's institutional framework poses an intermediate risk, reflecting the large number of key regulations the authorities have implemented over the past five years. Although UAE banks operate with healthy profitability metrics, a large number of key banks are controlled by either government-based institutions or ruling families, which we believe is a weakness in terms of competitive dynamics. UAE banks have improved their funding profiles over the past few years as credit growth has lagged deposit growth. We still consider that funding conditions pose intermediate risk.

Table 1

National Bank of Fujairah PJSC Key Figures					
	--Year-ended Dec. 31--				
(Mil. AED)	2015*	2014	2013	2012	2011
Adjusted assets	26,501	24,560	21,436	17,532	14,910
Customer loans (gross)	18,673	17,253	14,680	12,681	11,050
Adjusted common equity	2,888	2,756	2,371	2,142	1,956
Operating revenues	295	1,025	885	759	651
Noninterest expenses	107	387	324	280	256
Core earnings	149	505	393	306	281

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

Business position: NBF is a well-established corporate niche player with a focus on the UAE's vibrant trade finance market.

We regard NBF's business position as "moderate." Our assessment reflects the bank's limited market share and niche focus. At the same time, the bank has a well-established position in the corporate middle market, healthy revenue generation, and a predictable business model. We expect that the bank will manage growth conservatively.

Established in 1982, NBF is predominantly a corporate bank, and it has historically generated an important portion of its business in Dubai. Over recent years, the bank has expanded its business in Fujairah and Abu Dhabi, and we expect it will continue to do so over the next few years. A substantial amount of the bank's assets are relatively short-term working capital facilities.

As of year-end 2014, the Fujairah government, through the Department of Industry and Economy, owned 40.1% of the bank; 21.7% is owned by Easa Saleh Al Gurg LLC; 9.8% by Investment Corporation of Dubai--an investment arm of the Dubai government--and 5.2% by Al Fujairah Investment Company. The chairman of the bank, His Highness Sheikh Saleh Bin Mohamed Bin Hamad Al Sharqi, is the brother of the ruler of the Emirate of Fujairah. Although Fujairah has always represented a small proportion of NBF's lending book, we understand that the bank has preferential access to important infrastructure projects in the emirate.

As a bank with a strong focus on trade finance, NBF traditionally generates a larger portion of its revenues from fee income compared with its UAE-based peers. The bank operates with very limited exposure to capital markets, and all of its revenues come from its local lending operations and trade finance activities. We consider NBF's preprovision earnings to be quite predictable because the contribution of market-related income to revenues is limited.

Table 2

National Bank of Fujairah PJSC Business Position					
	--Year-ended Dec. 31--				
(%)	2015*	2014	2013	2012	2011
Total revenues from business line (mil. AED)	294.9	1,025.2	884.7	759.5	650.8
Commercial banking/total revenues from business line	74.1	76.5	80.2	84.9	85.3
Retail banking/total revenues from business line	7.6	7.1	7.3	7.1	7.3
Commercial & retail banking/total revenues from business line	81.7	83.5	87.5	92.0	92.6
Trading and sales income/total revenues from business line	18.3	16.5	12.5	8.0	7.4
Return on equity	16.4	15.8	14.8	14.1	14.4

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

Capital and earnings: Improving capital ratios

We regard NBF's capital and earnings position as "strong." This reflects our projection that our risk-adjusted capital (RAC) ratio for NBF (before adjustments) will remain at 13.5%-14% over the next 18–24 months, in line with healthy earnings generation. As of year-end 2014, the bank had a regulatory Tier I capital ratio of 14.6%, and the RAC ratio (before adjustments) stood at 13.1%. NBF's RAC ratio compares favorably with the global industry average and indicates strong capital, according to our criteria.

During 2014, NBF took constructive steps to improve its capitalization. It introduced a stock dividend policy under which it distributes only half of its dividends in cash. As a result, the bank was able to retain 84% of its earnings in its

equity base, compared with only 60% in 2010. On the other hand, the bank issued a second Tier I perpetual note of UAE dirham (AED) 500 million (about \$136 million) in March 2015. The subscription base consisted of a mix of current shareholders, affiliated parties, and new investors. The first tranche, in the same amount, was issued in March 2013. Under our criteria, this instrument has intermediate equity content, but also results in a slight deterioration in the quality of capital because hybrids now account for a larger portion of NBF's total adjusted capital.

We forecast the RAC ratio to remain comfortably in the 13.5%-14% range over the next 18-24 months, assuming:

- Lending growth of about 15-20% per annum over the next two years;
- A moderate compression of the net interest margin due to lower liquidity in the market, accompanied by strong growth of fee income;
- A slight increase in the cost-to-income ratio, which should remain below 40%, however;
- Stable asset quality, allowing for higher coverage of nonperforming loans (NPL) without a significant increase in the cost of risk; and
- A gradual decline in proportion of net income paid out as dividends to low double digits by 2017.

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

Table 3

National Bank of Fujairah PJSC Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2015*	2014	2013	2012	2011
Tier 1 capital ratio	15.6	14.6	15.7	13.6	14.1
S&P RAC ratio before diversification	N.M.	13.1	12.2	N.M.	N.M.
S&P RAC ratio after diversification	N.M.	10.6	11.5	N.M.	N.M.
Adjusted common equity/total adjusted capital	75.2	84.6	82.6	100.0	100.0
Net interest income/operating revenues	64.5	66.4	65.8	66.5	65.5
Fee income/operating revenues	26.7	24.6	25.2	23.9	25.1
Market-sensitive income/operating revenues	7.1	7.4	7.8	7.8	8.1
Noninterest expenses/operating revenues	36.2	37.8	36.6	36.9	39.4
Preprovision operating income/average assets	2.9	2.8	2.9	3.0	2.8
Core earnings/average managed assets	2.3	2.2	2.0	1.9	2.0

*Data as of March 31. N.M.--Not meaningful.

Table 4

National Bank of Fujairah PJSC RACF [Risk-Adjusted Capital Framework] Data					
(AED 000s)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	4,340,348	--	--	130,210	3
Institutions	2,904,422	--	--	1,223,609	42
Corporate	17,466,753	--	--	18,746,944	107
Retail	2,075,567	--	--	1,758,946	85

Table 4

National Bank of Fujairah PJSC RACF [Risk-Adjusted Capital Framework] Data (cont.)					
Of which mortgage	637,910	--	--	287,060	45
Securitization	0	--	--	0	0
Other assets	646,461	--	--	980,279	152
Total credit risk	27,433,551	--	--	22,839,989	83
Market risk					
Equity in the banking book¶	10,733	--	--	74,284	692
Trading book market risk	--	--	--	13,032	--
Total market risk	--	--	--	87,316	--
Operational risk					
Total operational risk	--	--	--	1,922,265	--
(AED 000s)	Basel II RWA		Standard & Poor's RWA	% of Standard & Poor's RWA	
Diversification adjustments					
RWA before diversification	--	--	24,849,570	100	
Total adjustments to RWA	--	--	5,851,720	24	
RWA after diversification	--	--	30,701,291	124	
(AED 000s)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)	
Capital ratio					
Capital ratio before adjustments	3,286,616	14.6	3,255,949	13.1	
Capital ratio after adjustments§	3,286,616	14.6	3,255,949	10.6	

*Exposure at default. Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. ¶Exposure and Standard & Poor's 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, 2014, Standard & Poor's.

Risk position: Asset quality metrics are improving

We assess NBF's risk position as "adequate" because its key asset-quality metrics are largely at par with the sector averages, and it generates more-than-adequate returns to cover the cost of risk from its lending operations. As a niche player in trade finance, the bank operates with lower single-party concentrations than its peers. For example, the 20 largest non-public-sector lending exposures represented about 17% of NBF's gross loans at year-end 2014, compared with 30%–35% for other banks we rate in the UAE. Similarly, NBF exhibits lower real estate and construction funded exposures. For example, as of year-end 2014, loans to these sectors comprised less than 12.6% of the loan book, compared with more than 25% for most banks in the region.

During the recent financial crisis, similar to other banks, NBF incurred loan losses predominantly from its lending to certain government-related entities in Dubai. The ratio of NPLs to gross loans peaked at 11% in 2010 and gradually improved to 4.4% as of year-end 2014. The bank's coverage of NPLs stood at 121% in 2014. In line with the ongoing recovery in Dubai and lower losses from loans granted after 2008, we expect the NPL ratio to continue declining and the bank to increase its coverage ratio to about 150% over the next two years.

About 5.8% of NBF's gross lending consisted of renegotiated exposures not classified as NPLs as of Dec. 31, 2014. If some restructured exposures were to become NPLs, we believe NBF's strong loan loss coverage ratio and capitalization would provide it with adequate loss-absorption capacity.

Table 5

National Bank of Fujairah PJSC Risk Position					
(%)	2015*	--Year-ended Dec. 31--			
		2014	2013	2012	2011
Growth in customer loans	8.2	17.5	15.8	14.8	17.9
Total diversification adjustment / S&P RWA before diversification	N.M.	23.5	5.9	N.M.	N.M.
Total managed assets/adjusted common equity (x)	9.2	8.9	9.0	8.2	7.6
New loan loss provisions/average customer loans	0.9	0.8	1.2	1.4	1.1
Net charge-offs/average customer loans	N.M.	0.2	1.0	0.3	1.2
Gross nonperforming assets/customer loans + other real estate owned	3.9	4.4	4.7	7.8	11.0
Loan loss reserves/gross nonperforming assets	132.2	121.4	118.4	79.7	53.9

*Data as of March 31. N.M.--Not meaningful.

Funding and liquidity: Healthy liquidity and funding metrics

We consider NBF's funding "average" and its liquidity "adequate." The bank funds itself predominantly from domestic customer deposits. As of year-end 2014, NBF's loan-to-deposit ratio stood at 91% and the ratio of stable funding resources to its funding needs was a healthy 116%, according to our calculations. Like other rated banks in the UAE, NBF exhibits funding concentrations. The 20 largest deposits represented about 54% of NBF's deposit base at year-end 2014. We expect deposits from NBF's shareholders and affiliated entities to remain stable, but note a significant reliance on deposits from other institutions.

The bank operates with a highly liquid balance sheet, and at year-end 2014 had more than \$1 billion with the Central Bank of the United Arab Emirates in the form of certificates of deposit and other placements. NBF's ratio of broad liquid assets to short-term wholesale funding was a healthy 5.5x at year-end 2014.

Table 6

National Bank of Fujairah PJSC Funding And Liquidity					
(%)	2015*	--Year-ended Dec. 31--			
		2014	2013	2012	2011
Core deposits/funding base	88.9	90.6	87.0	80.2	78.8
Customer loans (net)/customer deposits	96.0	91.1	92.4	104.3	111.9
Long term funding ratio	94.8	95.3	91.7	95.5	95.6
Stable funding ratio	112.4	116.2	112.3	106.5	103.4
Short-term wholesale funding/funding base	6.2	5.5	9.7	5.3	5.1
Broad liquid assets/short-term wholesale funding (x)	4.7	5.5	3.1	4.8	4.6
Net broad liquid assets/short-term customer deposits	29.0	30.4	25.2	27.5	26.3
Short-term wholesale funding/total wholesale funding	39.2	46.2	61.2	26.6	24.2
Narrow liquid assets/3-month wholesale funding (x)	6.0	7.1	3.9	6.4	5.0

*Data as of March 31.

External support: "Moderate" systemic importance in a "highly supportive" country

The long-term rating is two notches higher than the SACP to incorporate our view of a "moderately high" likelihood of extraordinary government support for NBF if needed. This is in line with the bank's "moderate" systemic importance in the UAE and our assessment of the UAE government as "highly supportive" toward the domestic banking sector.

Related Criteria And Research**Related Criteria**

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related Research

- Banking Industry Country Risk Assessment: United Arab Emirates, Jan. 21, 2014
- UAE Banking Sector Outlook 2014: An Uptick In Lending And Economic Activity Signal Continued Profitable Growth, Jan. 21, 2014
- Credit FAQ: How The UAE's Lending Caps Affect Domestic Banks, Government Entities, And The Capital Markets, Jan. 13, 2014
- Credit FAQ: How The United Arab Emirates' Caps On Mortgage Loans Will Affect Banks And Property Developers, Nov. 18, 2013

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 June 12, 2015)**National Bank of Fujairah PJSC**

Counterparty Credit Rating

BBB+/Stable/A-2

Counterparty Credit Ratings History

31-Mar-2014

BBB+/Stable/A-2

Ratings Detail (As Of June 12, 2015) (cont.)**Sovereign Rating**

Abu Dhabi (Emirate of)

AA/Stable/A-1+

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