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CREDIT OPINION

27 February 2023

Update

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RATINGS

National Bank of Umm Al-Qaiwain (PSC)

Domicile	United Arab Emirates
Long Term CRR	Baa1
Type	LT Counterparty Risk Rating - Fgn Curr
Long Term Deposit	Baa2
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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National Bank of Umm Al-Qaiwain (PSC)

Update to credit analysis

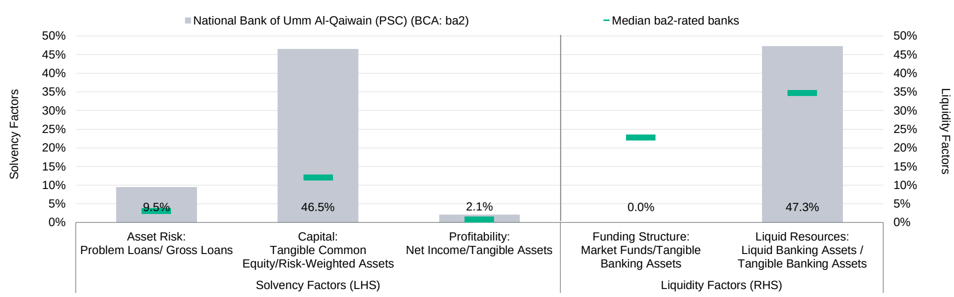
Summary

National Bank of Umm Al-Qaiwain (PSC)'s (NBQ) Baa2 long-term deposit ratings reflect the bank's ba2 Baseline Credit Assessment (BCA) and three notches of government support uplift from the Government of the United Arab Emirates (Aa2 stable) based on our expectation of a very high probability of government support. Our assessment reflects the Government of Umm Al Qaiwain's 30% stake in NBQ and the UAE authorities' track record of support for the country's banks in case of need.

NBQ's ba2 BCA reflects the bank's sound core profitability, which reflects its corporate franchise, and strong capital and liquidity buffers. These strengths are moderated by the bank's weak asset quality with high exposure to sector and borrower concentrations, and low loan loss reserves, concentrated funding profile, as well as its limited business diversification and the execution risks associated with the bank's medium-term growth plan.

Exhibit 1

Rating Scorecard - Key financial ratios



Problem loans and profitability ratios are the weaker of the three-year averages and the latest reported figures; the capital ratio is the latest reported figure; and the funding structure and liquid assets ratios are the latest year-end figures.
Source: Moody's Investors Service

Credit strengths

» Capital buffers expected to remain strong

» Profitability benefits from solid margins and efficient operations

» Liquidity buffers combined with low market funding reliance

» Very high probability of support from the UAE government in case of need

Credit challenges

» Weak asset quality exposed to high borrower and sector concentrations

» Concentrated funding book

» Limited business diversification

» Medium-term growth plan entails execution risks

Outlook

The stable outlook on NBQ’s long-term ratings reflects our expectation that pressure on the bank's asset quality and the execution risks of its medium-term growth plan will be balanced by strong liquidity and capital buffers.

Factors that could lead to an upgrade

Upward pressure on NBQ's long-term ratings could emerge from a significant improvement in operating conditions, leading to improvements in the bank's asset quality and profitability, and/or achieving diversification of its revenues from less volatile segments, while maintaining strong capital and liquidity buffers.

Factors that could lead to a downgrade

Downward pressure on NBQ's long-term ratings could materialise if there is a significant deterioration in operating conditions, leading to a weakening of the bank’s asset quality, profitability and/or capitalisation. Downward pressure on NBQ's ratings could also materialise if the bank fails to upgrade its risk management framework while growing in riskier segments.

Key indicators

Exhibit 2

National Bank of Umm Al-Qaiwain (PSC) (Consolidated Financials) [1]

	12-22[2]	12-21[2]	12-20[2]	12-19[3]	12-18[3]	CAGR/Avg.[4]
Total Assets (AED Million)	13,605.1	13,142.0	13,546.0	14,297.6	14,664.8	(1.9)[5]
Total Assets (USD Million)	3,704.4	3,578.0	3,687.9	3,892.5	3,992.4	(1.9)[5]
Tangible Common Equity (AED Million)	4,943.3	4,678.1	4,561.8	4,558.0	4,336.9	3.3[5]
Tangible Common Equity (USD Million)	1,346.0	1,273.6	1,241.9	1,240.9	1,180.7	3.3[5]
Problem Loans / Gross Loans (%)	9.5	8.6	10.0	8.7	7.3	8.8[6]
Tangible Common Equity / Risk Weighted Assets (%)	46.5	42.0	41.0	38.1	35.1	40.6[7]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	11.8	11.9	16.2	15.3	14.4	13.9[6]
Net Interest Margin (%)	3.0	2.1	2.4	3.5	3.6	2.9[6]
PPI / Average RWA (%)	3.5	2.3	2.8	4.2	4.2	3.4[7]
Net Income / Tangible Assets (%)	2.7	2.0	1.6	3.0	2.8	2.4[6]
Cost / Income Ratio (%)	28.8	34.7	31.5	22.0	22.3	27.9[6]
Market Funds / Tangible Banking Assets (%)	0.0	0.0	1.5	0.0	0.0	0.3[6]
Liquid Banking Assets / Tangible Banking Assets (%)	47.3	44.7	38.5	37.5	33.5	40.3[6]

Gross Loans / Due to Customers (%)	83.7	89.5	97.2	95.6	95.7	92.3[6]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] Basel II; IFRS. [4] May include rounding differences because of the scale of reported amounts. [5] Compound annual growth rate (%) based on the periods for the latest accounting regime. [6] Simple average of periods for the latest accounting regime. [7] Simple average of Basel III periods.
Sources: Moody's Investors Service and company filings

Profile

National Bank of Umm Al-Qaiwain (NBQ) is a public shareholding company incorporated in the Emirate of Umm Al Qaiwain in the UAE in 1982. The bank is engaged in providing retail, corporate and Islamic banking services through a network of 11 branches, ATMs, CCDMs, mobile banking and online banking in the UAE.

As of December 2022, the bank reported AED13.6 billion of total assets ($3.7 billion). The domestic market share of NBQ is at 0.4% as of September 2022. The bank's largest shareholder is the Government of Umm Al Qaiwain, which owns 30% of its total shares.

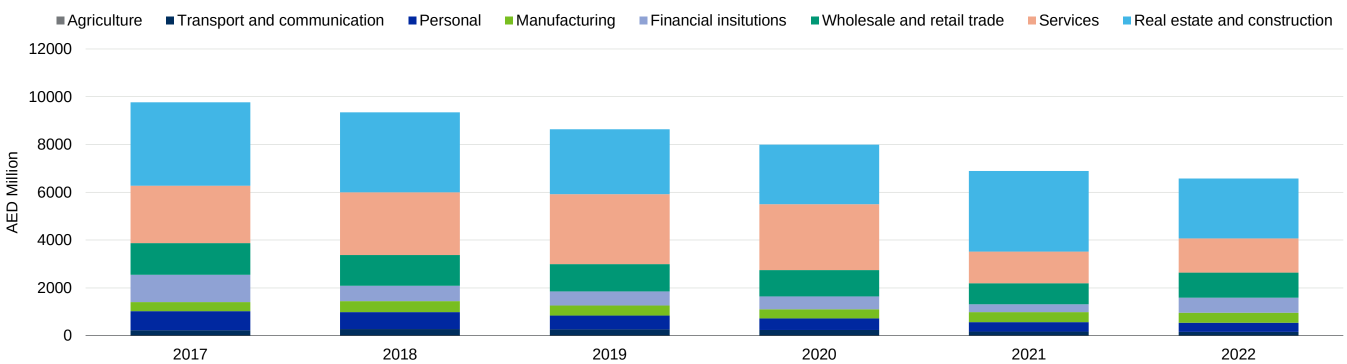
Detailed credit considerations

Weak asset quality exposed to high borrower and sector concentrations

We expect the bank's borrower and sector concentration to continue to pose risks to its asset quality. Furthermore, growth plans could further increase asset risk, creating a new unseasoned portion in the loan book.

NBQ has significant exposure to the cyclical real estate and construction sectors, with combined loans accounting for 38% of total loans as of the end of December 2022, one of the highest reported among the local banks. This exposes NBQ to the volatility of the real estate market in the UAE. However, the exposure to the real estate and construction sectors has substantially decline during 2022 - at 49% of total loans as of December 2021- down by 26% year-on-year, as the bank complies with updated real estate regulation from Central Bank.

Exhibit 3
Loan book breakdown evolution



Source: Bank's financial statements

The bank's loan book shrunk by 33% between year-end 2017-2022 because NBQ initially cleaned its wholesale banking portfolio, mainly real estate and construction, financial institutions (FI), and also services. The bank wrote off 19% and 16% of previous-year nonperforming exposures in 2019 and 2020, respectively, and around 4% and 6% in 2021 and 2022.

As of December 2022, NBQ's nonperforming loans/gross loans ratio was 9.5%, slightly higher than 8.6% as of 2021, driven by some NPL formation but also by a denominator effect as the bank's loan book shrunk by 5% in full-year 2022. The ratio still compares unfavourably with its UAE peers with an average NPL ratio at 6% (as of June 2022).

NBQ's loan loss reserves/problem loans was 54% as of the end of December 2022, down from 61% as of year-end 2018 and significantly lower than its peers, reducing the bank's additional buffers to absorb potential losses. The bank's accumulated loan loss reserves declined in 2020, as problem loan formation continued while the bank's cost of risk (loan loss provisions/gross loans) remained similar to pre-pandemic levels (at 1.2% in 2020 versus 1.1% in 2018-2019). The bank's cost of risk was at a low 0.34% in 2022, down also from pre-pandemic levels, as the operating environment recovered in the UAE.

Capital buffers expected to remain strong

We expect NBQ's capitalisation to remain strong, but to decline, as the bank implements its growth strategy.

As of December 2022, NBQ's Moody's tangible common equity (TCE)/risk-weighted assets was a high 46.5% (42% as of December 2021) up from an already high 35% as of 2018, because the denominator declined as the loan book shrunk.

NBQ will continue to meet capital requirements through retained profit, with a 50% dividend policy payout in recent years (dividend declared at 55% of 2022 net profits) with the exception of 2020 when the bank paid 70% of its profits to the shareholders.

As of December 2022, the bank's reported a Basel III Tier 1 ratio of 43.13%, total capital adequacy ratio of 44.27% and shareholders' equity/total assets of 39.2%, were well above those of the UAE local peers and adequate for its risk profile.

Profitability benefits from solid margins and efficient operations

We expect NBQ's profitability to remain sound in the outlook period. NBQ's solid profitability is supported by the bank's corporate franchise, which is underpinned by the bank's strong ties with the UAE corporate groups and families. However, its growth plan could hurt bottom-line profitability if provisions increase.

NBQ's net interest margin increased to 3.0% for 2022 from 2.1% in 2021 because gross yields increased faster than funding costs — 0.8% in 2022 compared with 0.6% in 2021 — returning to pre-pandemic levels.

The bank's cost-to-income ratio was 28.8% in full-year 2022, lower when compared to a 34.7% during 2021. The decline in the cost-to income ratio was mainly driven by significantly higher operating income while operating expenses was slightly up as the bank invests in digitalization.

In full-year 2022 the bank's loan-loss provision to pre-provision income amounted to 6%, driven by loan book reduction and the recovered operating environment in the UAE, versus 31% in 2020 and 18% in 2019 which were reflective of prepandemic challenges in the commercial and business banking segments and covid-19 related provisions in 2020. In full-year 2021 the bank had reported a release in provisions at 6% of pre-provision income, driven by loan book reduction and partially also recoveries.

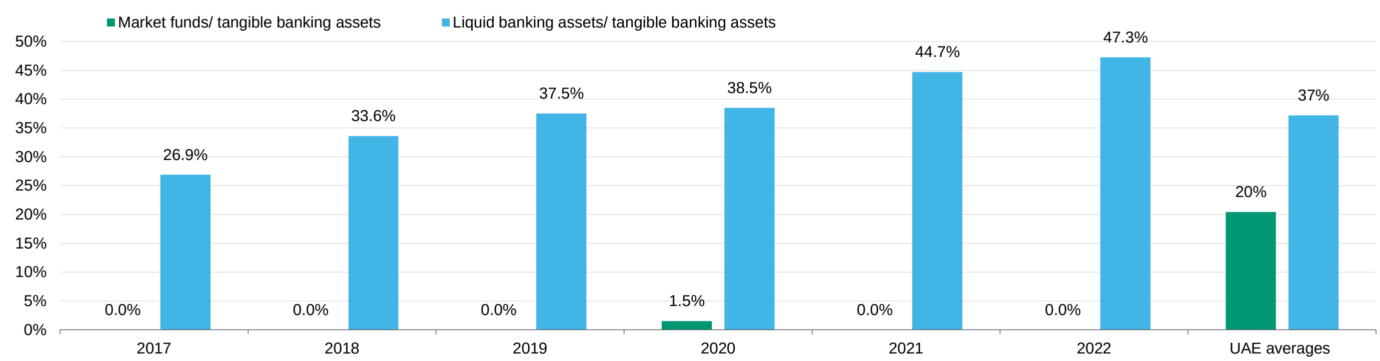
NBQ reported a net income to tangible assets of 2.7% in full-year 2022, up from 2.0% in full-year 2021.

High liquidity buffers combined with low market funding reliance

NBQ's assets are mainly funded by customer deposits, constituting 95% of non-equity funding as of December 2022. The bank has a high reliance on high-cost time deposits, at 61% of total customer accounts as of December 2022, although this improved from the 2018 level (76%). The funding book also exhibits high concentration, with 43% of the deposits sourced from related parties as of December 2022, significantly up from 21% as of 2018, reflecting the corporate nature of NBQ's franchise.

However, market funding reliance remained nil as of December 2022. The ratio of net loans to customer deposits declined to 79% at end-December 2022 from 86% in 2021, as the loan book shrunk by 5% while the deposit book grew by 2%.

Exhibit 4
Liquid assets and market funds



Source: Banks financial statements

NBQ's liquid buffers mitigate the concentration risk in NBQ's funding profile. The bank's liquid banking assets/tangible banking assets increased to 47.3% as of December 2022, from 33.5% in 2018. We expect the bank's liquid assets to decline but to remain relatively solid, as the bank implements its medium-term growth plan.

Limited business diversification

The negative adjustment for Business Diversification reflects NBQ's limited business diversification constraining its credit strength, since it increases the bank's sensitivity to stress in a single business line. NBQ's strong reliance on medium-sized corporate banking limits its income diversification and increases earnings volatility.

Medium-term growth plan entails execution risks

The negative adjustment for Corporate Behavior reflects the execution risks of the bank's new growth plan to diversify from its sector concentration in real estate. The lack of a track record, substantial growth plans combined with existing risk management and control framework, constrain the bank's credit strength and create uncertainties regarding the evolution of the bank's risk profile.

ESG considerations

National Bank of Umm Al-Qaiwain (PSC)'s ESG Credit Impact Score is Highly Negative CIS-4

Exhibit 5

ESG Credit Impact Score

CIS-4

Highly Negative

NEGATIVE IMPACT

POSITIVE IMPACT

For an issuer scored CIS-4 (Highly Negative), its ESG attributes are overall considered as having a discernible negative impact on the current rating. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-3.

Source: Moody's Investors Service

National Bank of Umm Al-Qaiwain's ESG Credit Impact Score is highly negative (**CIS-4**). This reflects a greater potential for governance risks incorporated in the one-notch negative rating adjustment for corporate behavior, stemming from lack of track record of growth strategy execution combined with risk management framework in place. The score also reflects the limited credit impact of environmental and social risk factors on the rating to date.

Exhibit 6

ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-4	S-3	G-4
Highly Negative	Moderately Negative	Highly Negative

Source: Moody's Investors Service

Environmental

National Bank of Umm Al-Qaiwain faces highly negative exposure to environmental risks, mainly because of carbon transition risk. Although the bank has limited direct lending exposure to carbon-intensive sectors, the contribution of the hydrocarbon industry to the UAE economy (although low hydrocarbon production costs provide a degree of insulation to carbon transition), as well as its dependence on desalinated water and exposure to rising sea levels, increases its vulnerability to environmental risks, potentially affecting the creditworthiness of the bank's counterparties.

Social

National Bank of Umm Al-Qaiwain faces moderate social risks related to regulatory and litigation risks. Demographic trends have favored adaptation of the population towards financial inclusion and innovation in city centers. NBQ and UAE banks are generally focused on intermediation with simpler product ranges and counterparties. Consumer protection regulation partially mitigates mis-selling and mis-representation risks.

Governance

National Bank of Umm Al-Qaiwain faces highly negative governance risks. Lack of track record of strategy execution in recent years and current risk management framework in place heighten these risks. Government of Umm al Qaiwain owning around one-third of the bank's shares and majority of the Board members being non-independent, also increase governance risks. However, the country's developed institutional framework mitigates some of these risks. The bank is a publicly-listed firm and provides timely external reporting

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Both government ownership and the UAE authorities' track record support our view that NBQ will receive support in case of need

NBQ's Baa2 long-term deposit ratings take into consideration the bank's ba2 BCA and three notches of government support uplift from the UAE government based on our expectation of a very high probability of government support. Our assessment reflects the Government of Umm Al Qaiwain's 30% stake in NBQ and the UAE authorities' track record of support for the country's banks in case of need.

Counterparty Risk Ratings (CRRs)

NBQ's CRRs are Baa1/Prime-2

We consider the UAE a jurisdiction with a nonoperational resolution regime. For nonoperational resolution regime countries, the starting point for the CRR is one notch above the bank's Adjusted BCA. However, the CRRs benefit from three notches of government support uplift, based on our assessment of a very high probability of government support.

Counterparty Risk (CR) Assessment

NBQ's CR Assessment is Baa1(cr)/P-2(cr)

Source of facts and figures cited in this report

Unless noted otherwise, we have sourced data related to systemwide trends and market shares from the central bank. Bank-specific figures originate from banks' reports and Moody's Banking Financial Metrics. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document Financial Statement Adjustments in the Analysis of Financial Institutions, published on 9 August 2018.

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 7

National Bank of Umm Al-Qaiwain (PSC)

Macro Factors		
Weighted Macro Profile	**Strong -**	**100%**

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	9.5%	ba3	↓	b3	Single name concentration	Sector concentration
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	46.5%	aa3	↔	a2	Expected trend	Capital retention
Profitability						
Net Income / Tangible Assets	2.1%	a1	↓	baa3	Expected trend	Loan loss charge coverage
Combined Solvency Score		baa1		ba1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	0.0%	aa3	↔	baa1	Deposit quality	Expected trend
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	47.3%	a2	↔	a3	Expected trend	
Combined Liquidity Score		a1		baa1		
Financial Profile				baa3		
Qualitative Adjustments				Adjustment		
Business Diversification				-1		
Opacity and Complexity				0		
Corporate Behavior				-1		
Total Qualitative Adjustments				-2		
Sovereign or Affiliate constraint				Aa2		
BCA Scorecard-indicated Outcome - Range				ba1 - ba3		
Assigned BCA				ba2		
Affiliate Support notching				0		
Adjusted BCA				ba2		

Instrument Class	**Loss Given Failure notching**	**Additional notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency Rating**	**Foreign Currency Rating**
Counterparty Risk Rating	1	0	ba1	3	Baa1	Baa1
Counterparty Risk Assessment	1	0	ba1 (cr)	3	Baa1(cr)	
Deposits	0	0	ba2	3	Baa2	Baa2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 8

Category	**Moody's Rating**
NATIONAL BANK OF UMM AL-QAIWAIN (PSC)	
Outlook	Stable
Counterparty Risk Rating	Baa1/P-2
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Counterparty Risk Assessment	Baa1(cr)/P-2(cr)

Source: Moody's Investors Service

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