MOODY'S
INVESTORS SERVICE

# Rating Action: Moody's assigns first-time ratings to National Bank of Umm Al-Qaiwain

11 Feb 2022

**Local and foreign currency deposit ratings at Baa2 with stable outlook**

Limassol, February 11, 2022 -- Moody's Investors Service ("Moody's") has today assigned first-time local and foreign currency long-term and short-term bank deposit ratings of Baa2/Prime-2 to National Bank of Umm Al-Qaiwain (PSC) (NBQ). The outlook assigned to the long-term deposit ratings is stable. At the same time, the rating agency has assigned a Baseline Credit Assessment (BCA) and Adjusted BCA of ba2, long-term and short-term Counterparty Risk (CR) Assessments of Baa1(cr)/P-2(cr), long-term local and foreign currency Counterparty Risk Ratings (CRR) of Baa1, and short-term local and foreign currency CRRs of P-2.

A list of the assigned ratings is available at the end of this press release.

RATINGS RATIONALE

National Bank of Umm Al-Qaiwain (PSC) (NBQ) is a public shareholding company incorporated in the emirate of Umm Al Qaiwain in the United Arab Emirates (UAE) in 1982. The bank is engaged in providing corporate and retail banking services through a network of 12 branches in the UAE. As of December 2021, the bank reported AED 13.1 billion of total assets (USD 3.6 billion), which corresponds to 0.4% market share in the UAE.

RATIONALE FOR BCA

NBQ's ba2 BCA captures the bank's sound core profitability, reflective of its corporate franchise, and its 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 absorption reserves, concentrated funding profile, limited business diversification and execution risks arising from the bank's medium-term growth plan.

DETAILED CREDIT CONSIDERATIONS

--PROFITABILITY BENEFITS FROM SOLID MARGINS AND EFFICIENT OPERATIONS

Moody's expects that NBQ's profitability will increase, as the operating environment improves in the UAE. NBQ's solid profitability continues to be supported by the bank's corporate franchise which is underpinned by the strong ties of the bank with UAE corporate groups and families. However, planned growth in higher risk segments could eventually impact bottom-line profitability as provisions increase.

Net interest margin has declined to 2.1% for 2021 from 3.5% in 2019, as gross yields decreased more than funding costs - at 0.6% in 2021 compared with 1.1% in 2019 - driven by a combination of lower interest rates and negative loan book growth.

The bank's cost-to-income ratio was a strong 35% for 2021, broadly in line with the previous year.

Loan-loss provisions consumed 31% of the bank's pre-provision income in 2020, compared with 18% in 2019. This reflected pre-pandemic challenges in some commercial and business banking segments combined with covid-19 management overlays in 2020. In 2021 the bank 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 ratio at 2.0% for 2021 and 1.6% in 2020, down from 3.0% in 2019.

--CAPITAL BUFFERS EXPECTED TO REMAIN STRONG

Moody's says that it expects NBQ will maintain strong capital adequacy, although this could decline slightly as the bank implements its growth strategy.

As at December 2021 Moody's Tangible Common Equity (TCE) to risk weighted assets ratio was at a high 42% (stable from 41% in December 2020) up from an already high 35% in 2018, mainly reflecting the shrinking loan portfolio.

The bank will continue to meet capital requirements through retained profit, with a 50% dividend policy payout in recent years, with exception of 2020 where the bank paid 70% of its profit to the shareholders. As of year-end 2021 the bank declared it will pay around 56% of net profits to its shareholders. As of December 2021, the bank's reported a Basel III Tier 1 ratio of 43.53%, total capital adequacy ratio of 44.66% and shareholders' equity/total assets of 38.4%, were well above the UAE local peers and adequate for its risk profile.

--HIGH LIQUID 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 2021. The bank exhibits a high reliance on high-cost time deposits, at 58% of total customer accounts as of December 2021, although this has improved from its 2018 level (76%). The funding book also exhibits high concentration, with 36% of deposits being sourced from related parties as of December 2021, up from 21% in 2018, reflecting the corporate nature of NBQ's franchise.

However, market funding reliance is nil as of December 2021, down from an already low 1.5% as of December 2020. The ratio of net loans to customer deposits stood at 86% at end-December 2021.

NBQ's liquid buffers mitigate the concentration risk in its funding profile. The bank's liquid banking assets/tangible banking assets increased to 44.7% as of December 2021, from 33.6% 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.

--WEAK ASSET QUALITY EXPOSED TO HIGH BORROWER AND SECTOR CONCENTRATIONS

We expect NBQ's asset quality to be affected by the lagging effect of the covid 19 outbreak period. Furthermore, growth plans could further increase asset risk, creating a new unseasoned portion in the loan book.

Credit concentration also represents a risk to the bank's asset quality. In particular, NBQ's exposure to the cyclical real estate and construction sectors with combined loans accounting for a high 49% of total loans at end December 2021, exposes NBQ to the volatility of the real estate market in the UAE.

The bank's loan book declined by 30% between year-end 2017-2021, as the bank cleaned-up its wholesale banking portfolio, mainly real estate and construction, financial institutions and lastly also services. The bank wrote off 19% and 16% of previous year impaired exposure in 2019 and 2020 respectively, and a further 5% during 2021.

As of December 2021, NBQ's nonperforming loans to gross loans ratio was at 8.6%, down from 10% as of December 2020, but higher compared with 7.4% in 2018.

The bank's cost of risk (loan loss provisions to gross loans) in 2020 was similar to its pre-pandemic level at 1.2% (1.1% in 2018-2019) while the bank's accumulated loan loss reserves declined as problem loan formation continued. NBQ's loan loss reserves to problem loans ratio was at 51% at end-December 2021 down from 61% at end-2018, reducing the bank's buffers to absorb potential loan losses.

--LIMITED BUSINESS DIVERSIFICATION

Moody's makes a one-notch negative adjustment to Business Diversification to reflect NBQ's limited business diversification. NBQ's business concentration in corporate banking constrains its credit strength, since it increases the bank's sensitivity to stress in a single business line. The bank's strong reliance on mid-size corporate banking limits its income diversification and increases earnings volatility.

--MEDIUM TERM GROWTH PLAN ENTAILS EXECUTION RISKS

Moody's makes a one-notch negative adjustment to Corporate Behavior to reflect the execution risk of the bank's growth plan to diversify away from real estate sector, growing also its SME and retail segments. Lack of track record, substantial growth plans combined with existing risk-management and control framework, constrain the bank's credit strength and create uncertainties about the evolution of the bank's risk profile.

ENVIROMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

In line with the banking sector, NBQ has a low exposure to environmental risks as direct lending to the hydrocarbon sector is low. However, given the sizeable contribution of the hydrocarbon industry to the UAE economy and the arid nature of the country, UAE banks' indirect exposure to the hydrocarbon sector and to the local climate may increase their vulnerability to environmental risks.

The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy. Fines and reputational damage due to product mis-selling or other types of misconduct is a further social risk. Societal trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services increasing information technology cost, or socially driven policy agendas that may translate into regulation that affects banks' revenue base. Overall, we consider banks to face moderate social risks.

Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Governance is highly relevant for NBQ, as it is to all banks operating in the GCC. In the GCC, governments, along with government-related issuers, tend to have a large footprint on the overall economy. Consequently, they are often among the largest borrowers, depositors and in some cases shareholders in the largest banks across the region. Corporate governance remains a key credit consideration and requires ongoing monitoring.

RATIONALE FOR LONG-TERM DEPOSIT RATINGS

NBQ's Baa2 deposit ratings incorporate a three-notch uplift from its ba2 BCA, based on our assessment of a very high likelihood of government support, in case of need. This assessment reflects (1) Government of Umm Al-Qaiwain's 30.0% direct stake in NBQ and (2) the UAE's strong track record of supporting banks in times of stress.

RATING OUTLOOK

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

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upwards pressure on NBQ's long-term ratings could emerge from 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.

Downwards pressure on NBQ's long-term ratings could materialise in the event of a material deterioration in the operating conditions that could lead to 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.

LIST OF AFFECTED RATINGS

..Issuer: National Bank of Umm Al-Qaiwain (PSC)

Assignments:

....Adjusted Baseline Credit Assessment, Assigned ba2

....Baseline Credit Assessment, Assigned ba2

....Short-term Counterparty Risk Assessment, Assigned P-2(cr)

....Long-term Counterparty Risk Assessment, Assigned Baa1(cr)

....Short-term Foreign and Local Currency Counterparty Risk Ratings, Assigned P-2

....Long-term Foreign and Local Currency Counterparty Risk Ratings, Assigned Baa1

....Short-term Foreign and Local Currency Bank Deposit Ratings, Assigned P-2

....Long-term Foreign and Local Currency Bank Deposit Ratings, Assigned Baa2, Outlook Assigned Stable

Outlook Action:

....Outlook, Assigned Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1269625 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The local market analyst for this rating is Francesca Paolino, +971 (423) 795-68 .

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1288235 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the UK and is endorsed by Moody's Investors Service Limited, One Canada Square, Canary Wharf, London E14 5FA under the law applicable to credit rating agencies in the UK. Further information on the UK endorsement status and on the Moody's office that issued the credit rating is available on www.moodys.com.

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Nondas Nicolaides
VP - Senior Credit Officer
Financial Institutions Group
Moody's Investors Service Cyprus Ltd.
Porto Bello Building
1, Siafi Street, 3042 Limassol
PO Box 53205
Limassol CY 3301
Cyprus
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Henry MacNevin
Associate Managing Director
Financial Institutions Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Cyprus Ltd.
Porto Bello Building
1, Siafi Street, 3042 Limassol
PO Box 53205
Limassol CY 3301
Cyprus
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454