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CREDIT OPINION

7 May 2024

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 following rating affirmation

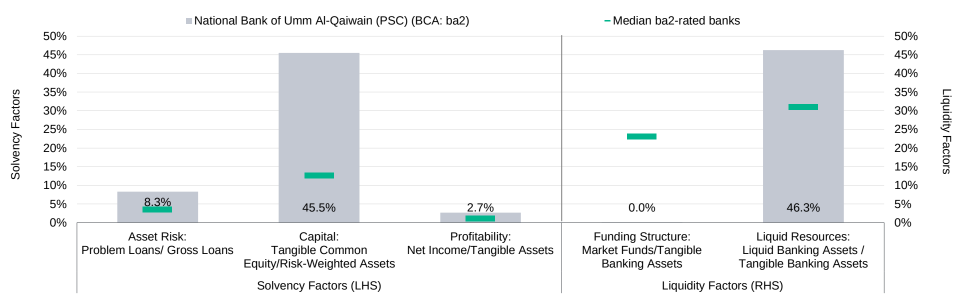
Summary

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 Ratings

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 deposit ratings reflects our expectation that pressure on the bank's weak asset quality and funding concentration risks 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. Upward pressure could also result from the bank building a track record of management execution of a consistent growth strategy and/or an improvement in the risk management and control framework.

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 implementing its growth strategy.

Key indicators

Exhibit 2

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

	12-23[2]	12-22[2]	12-21[2]	12-20[2]	12-19[3]	CAGR/Avg.[4]
Total Assets (AED Million)	14,777.2	13,605.1	13,142.0	13,546.0	14,297.6	0.8[5]
Total Assets (USD Million)	4,023.5	3,704.4	3,578.0	3,687.9	3,892.5	0.8[5]
Tangible Common Equity (AED Million)	5,252.7	4,943.3	4,678.1	4,561.8	4,558.0	3.6[5]
Tangible Common Equity (USD Million)	1,430.2	1,346.0	1,273.6	1,241.9	1,240.9	3.6[5]
Problem Loans / Gross Loans (%)	6.8	9.5	8.6	10.0	8.7	8.7[6]
Tangible Common Equity / Risk Weighted Assets (%)	45.5	46.5	42.0	41.0	38.1	42.6[7]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	9.0	11.8	11.9	16.2	15.3	12.8[6]
Net Interest Margin (%)	4.3	3.0	2.1	2.4	3.5	3.1[6]
PPI / Average RWA (%)	5.1	3.1	2.0	2.6	4.0	3.4[7]
Net Income / Tangible Assets (%)	3.4	2.7	2.0	1.6	3.0	2.5[6]
Cost / Income Ratio (%)	23.1	31.6	37.5	33.0	22.6	29.6[6]
Market Funds / Tangible Banking Assets (%)	0.0	0.0	0.0	1.5	0.0	0.3[6]
Liquid Banking Assets / Tangible Banking Assets (%)	46.3	47.3	44.7	38.5	37.5	42.8[6]

Gross Loans / Due to Customers (%)	82.2	83.7	89.5	97.2	95.6	89.6[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 Ratings 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 2023, the bank reported AED14.8 billion of total assets ($4.0 billion). The domestic market share of NBQ is at 0.4% as of December 2023. The bank's largest shareholder is the Government of Umm Al Qaiwain, which owns 30% of its total shares.

Detailed credit considerations

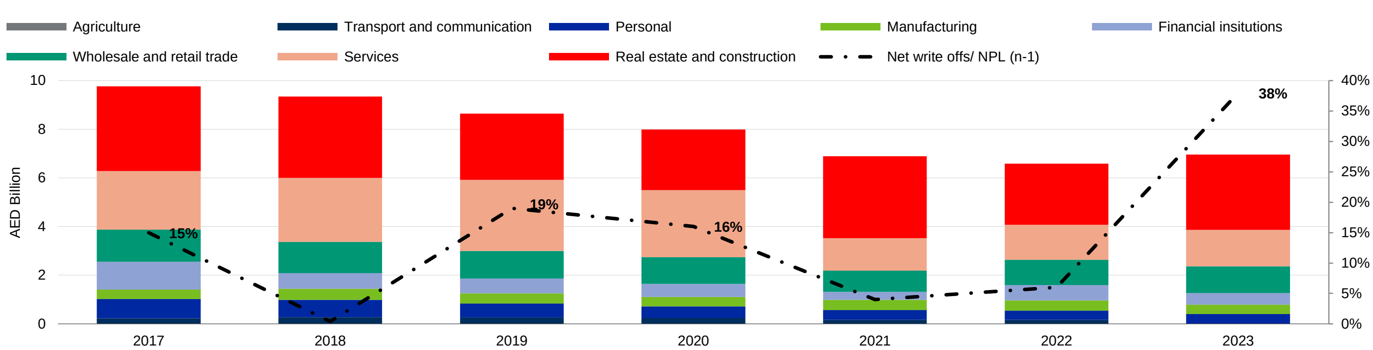
Weak asset quality exposed to high borrower and sector concentrations

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 43% of total loans as of December 2023 (38% at year-end 2022), one of the highest reported among the UAE banks. This exposes NBQ to the volatile real estate market in the UAE.

We also note NBQ's exposure to the real estate and construction sectors substantially declined in 2022 and then increased during 2023 (up by 24% year-over-year). We expect the bank to reduce or limit their exposure to real estate and construction in the future to comply with updated real estate regulation from Central Bank.[1]

Exhibit 3
Loan book breakdown and write-off evolution



Source: Bank's financial statements

The bank's loan book shrunk by 33% between year-end 2017-2022 because NBQ cleaned its wholesale banking portfolio - mainly real estate and construction, financial institutions (FI), and also services. In 2023 it returned to growth reporting an increase in the loan book by 9% mainly driven by real estate and construction exposure growth. The bank's write off activity was especially high in 2019 and 2020 (Exhibit 3), then it normalized in 2021-2022, and went back up in 2023 with a peak net write-off at 38% of previous year NPL.

The bank's problem loans to gross loans improved to 6.8% as of December 2023 from 9.5% in YE 2022, mainly driven by high write offs and marginally by a denominator effect - as gross loans grew by 9% in full-year 2023. Nonetheless, the ratio still compares unfavourably with its UAE peers (average NPL ratio at 4.3%).

The bank's reported cost of risk was at 65 basis points (bps) as of December 2023, lower than pre-pandemic levels. NBQ's loan loss reserves/problem loans was 37% as of December 2023, down from 61% as of December 2018 and significantly lower than its peers, reducing the bank's additional buffers to absorb potential losses.

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 2023, Moody's tangible common equity (TCE)/risk-weighted assets was a high 45.5% at NBQ (46.5% as of December 2022), up from an already high 35% as of 2018, because the denominator declined as the loan book shrunk (during 2018-2022).

NBQ will continue to meet capital requirements through retained profit, with a 50% dividend policy payout in recent years with the exception of 2020 when the bank paid 70% of its net profits to the shareholders. Dividend payout was at 60% on 2023 net profits.

As of the end of December 2023, the bank's reported a Basel III Tier 1 ratio of 41.6%, total capital adequacy ratio of 42.8% and shareholders' equity/total assets of 38.2%, which were all well above the ratios 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.

Moody's net interest margin at NBQ increased to 4.3% in full-year 2023 from 3.0% in full-year 2022 because gross yields increased faster than funding costs — 2.1% in 2023 compared with 0.8% in full year 2022— well above pre-pandemic levels. Cost of funds at NBQ remains lower than peers as the bank's shareholders' equity to total assets ratio is four times the local average (38% versus 11% as of December 2023), and this in turn supports NBQ's solid margins.

The bank's cost-to-income ratio was 23.1% in 2023, considerably lower when compared to 31.6% in full-year 2022. The decline in the cost-to-income ratio was mainly driven by significantly higher operating income offsetting slightly higher operating expenses as the bank continues to invest in its digital proposition.

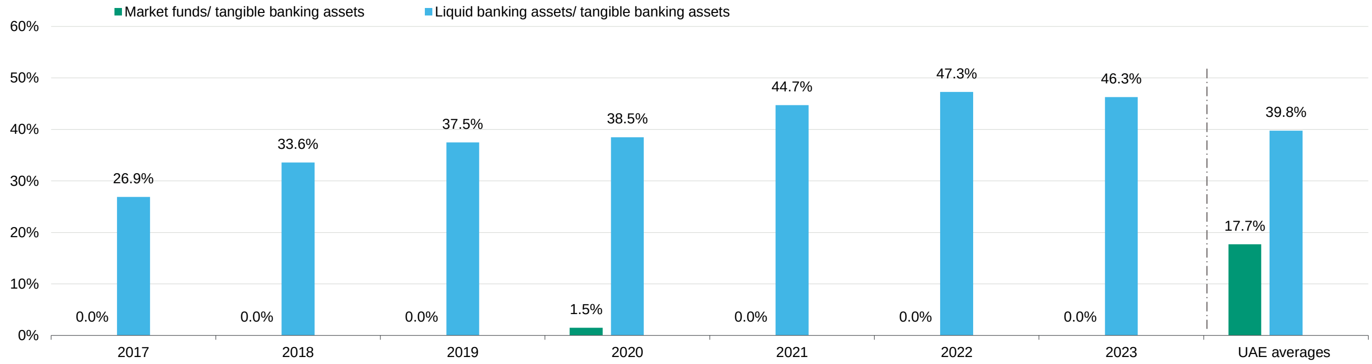
In full-year 2023 the bank reported loan-loss provision (LLP) to pre-provision income (PPI) at 8.4%, lower than pre-pandemic levels (2018-2019). In 2022 and 2021 the bank's ratio was negative (LLP to PPI at -7.0% in 2022 and -19% in 2021) accounting for the bank's one-off recoveries.

As a result of the above, NBQ reported a net income to tangible assets of 3.4% in full-year 2023, up from 2.7% in full-year 2022.

High liquidity buffers combined with low market funding reliance

NBQ's assets are mainly funded by customer deposits, constituting 96% of non-equity funding as of December 2023. The bank has a high reliance on high cost time deposits, at 63% of total customer accounts as of December 2023, although this improved from the 2018 level (76%). The funding book also exhibits high concentration, with 47% of the deposits sourced from related parties as of December 2023, reflecting also the corporate nature of NBQ's franchise.

Exhibit 4
Liquid assets and market funds



Source: Banks financial statements

However, market funding reliance remained zero as of December 2023. The ratio of net loans to customer deposits was broadly stable at 80% as of December 2023 (79% at year-end in 2022) as loan book growth at 12% offset deposit growth which was at 11%.

NBQ's liquid buffers mitigate the concentration risk in NBQ's funding profile. The bank's liquid banking assets/tangible banking assets further increased to 46.3% as of December 2023, from 33.6% in 2018 (Exhibit 4). We expect the bank's liquid assets to decline as the bank implements its medium-term growth plan, but to remain solid.

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 growth plan to diversify from its sector concentration in real estate. The lack of a track record combined with existing risk management and control framework, constrain the bank's credit strengths 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 CIS-4

Exhibit 5
ESG credit impact score

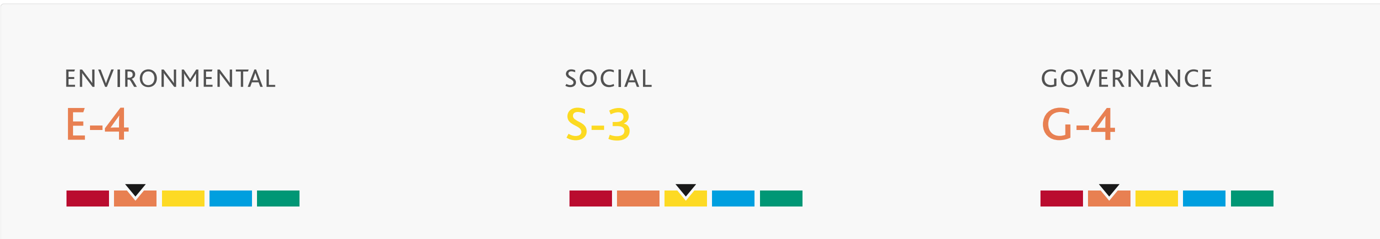
CIS-4

ESG considerations have a discernible impact on the current rating, which is lower than it would have been if ESG risks did not exist. The negative impact of ESG considerations on the rating is higher than for an issuer scored CIS-3.

Source: Moody's Ratings

National Bank of Umm Al-Qaiwain's **CIS-4** indicates a material impact of ESG considerations on the bank's ratings, mostly because of the bank's high governance risks incorporated in a one-notch negative rating adjustment for corporate behavior. The bank's corporate governance risks mainly stems from lack of track record of growth strategy execution combined with risk management framework in place. Environmental and social factors have a limited impact on the bank's credit profile to date.

Exhibit 6
ESG issuer profile scores



Source: Moody's Ratings

Environmental

National Bank of Umm Al-Qaiwain faces relatively high 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, mostly related to customer relations and associated regulatory and litigation risks. Demographic trends have favored financial inclusion and adaptation innovation of the population in the city centers. National Bank of Umm Al-Qaiwain and UAE banks are generally focused on the intermediation of simple, plain vanilla products. Less prone to mis-selling.

Governance

National Bank of Umm Al-Qaiwain faces high governance risks, reflecting lack of track record of strategy execution in recent years and current risk management framework in place. Government of Umm al Qaiwain owning around one-third of the bank does not result in incremental governance risks because of the country's developed institutional framework and is also mitigated by the composition of the Board which is by the majority independent. 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

Very high likelihood of government 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.

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 1 February 2024.

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	8.3%	ba3	↑	b3	Single name concentration	Sector concentration	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - fully loaded)	45.5%	aa3	↔	a2	Expected trend	Risk-weighted capitalisation	
Profitability							
Net Income / Tangible Assets	2.7%	aa3	↓	baa3	Expected trend	Loan loss charge coverage	
Combined Solvency Score		a3		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	46.3%	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 Ratings

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 Ratings

Endnotes

1 The UAE central bank has recently updated regulation which helps limit domestic banks' exposure to the historically volatile real estate sector. The regulator has capped exposure in the sector to 30% of each bank's credit risk-weighted assets, which includes off-balance sheet items and investments in real estate securities other than loans.

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