Credit Rating Report

NATIONAL BANK OF UMM AL QAIWAIN

Country: United Arab Emirates; **Report Date**: 8 September 2023

Rating Action Snapshot

- **Foreign Currency**: LT and ST Affirmed; Outlook Remains Stable.
- **Core Financial Strength**: CFS Affirmed.

Current Bank Ratings

International Issuer Credit Ratings	
Long-Term Foreign Currency (LT FCR)	**A-**
Short-Term Foreign Currency (ST FCR)	**A2**
LT FCR Outlook	**Stable**
Other	
Bank Standalone Rating (BSR)	**bbb**
BSR Outlook	**Stable**
Core Financial Strength (CFS)	**bbb**
Extraordinary Support Level (ESL)	**High**
Operating Environment Risk Anchor (OPERA)	**bbb**

Financial Highlights

AEDmn	**H1 23**	**2022**
Total Assets	14,062	13,605
Gross Customer Loans	6,642	6,580
Customer Deposits	8,276	7,862
Total Equity	5,366	5,327
Net Profit	255	365
Total Assets (USDmn)	*3,828*	*3,704*
Selected Ratios, %		
NPLs/ Gross Loans	7.8	9.5
LLR/ NPLs	45.0	53.6
Tier 1 Ratio	44.9	43.1
Loans/ Deposits	77.4	79.4
Cost/ Income	20.6	28.9
ROAA	3.6	2.7

Key Rating Factors

Credit Strengths

- High likelihood of support from the federal government.
- Large capital base; solid, peer-group-best capital ratios and strong balance sheet leverage.
- Wide NIM and a low-cost base underpin the Bank's good operating profitability and ROAA.
- Good liquidity, sizeable medium-term customer deposit base and small maturity gaps.

Credit Challenges

- High NPLs and low LLR coverage, mitigated by sizeable collateral and capital cushion.
- Customer concentrations in loans and deposits, and sector concentration in real estate/construction.
- Small size, low market share and limited business diversification.
- Slowing global economic growth due to inflationary pressures.

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RATING RATIONALE

Rating Action

Capital Intelligence Ratings (CI Ratings or CI) has affirmed the LT FCR and ST FCR of National Bank of Umm Al Qaiwain (NBQ) at 'A-' and 'A2', respectively. At the same time, CI Ratings has affirmed the Bank's BSR of 'bbb', CFS rating of 'bbb' and ESL of High. The Outlook for the LT FCR and BSR is Stable.

Rating Drivers

NBQ's LT FCR is set two notches above the BSR and reflects the ESL of High. CI expects the Bank to receive extraordinary 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 willingness to continue to do so in the future. Additionally, NBQ can also expect support from the government of Umm Al Quwain, a founding shareholder.

NBQ's BSR is derived from a CFS rating of 'bbb' and an OPERA of 'bbb'. The CFS reflects the Bank's long track record of generating strong earnings, very solid capital ratios and good liquidity. Principal challenges are high NPLs (partially mitigated by substantial collateral and capital), low loan-loss reserve (LLR) coverage, customer concentrations in loans and deposits, and sector concentration in real estate/construction. The slowing global economy due to high interest rates and monetary tightening by central banks is also a challenge, although the UAE is still doing well on the back of favourable oil prices. The Bank's undiversified business base and declining market share along with its small balance sheet size also weighs negatively on the CFS.

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.

The Bank's very conservative business strategy and credit policy over the past decade has served to safeguard capital and ensure strong liquidity. Thus far, the Bank has been able to overcome the disadvantages of a small customer franchise and limited business diversification to generate good earnings every year. Shareholders have been amply rewarded without compromising capital ratios. However, NBQ's share of business in the UAE has shrunk and it is currently the smallest commercial bank in the country. Rising competitive pressures in a consolidating banking sector could adversely impact its franchise over the long term.

NBQ continues to maintain a very conservative lending stance. Although it has booked new loans in its targeted segment, credit repayments have exceeded loan disbursals resulting in a steady decline in loans. However, H1 23 saw moderate loan growth for the first time in many years. The Bank has a large due from banks portfolio which is of good quality, and a moderate sized investment book comprising mainly equities of blue-chip banks and companies in the UAE. There are customer concentrations in the loan portfolio, in common with peer banks. There is also some concentration to the real estate sector, but the book is performing adequately.

Asset quality ratios had been weaker than sector average for many years partly because of legacy NPLs and the decline in gross loans. The NPL ratio improved in H1 23 due to lower NPLs (reflecting write-offs) and the growth in lending. We expect further improvements in the NPL ratio as the credit book is expanded or recoveries rise. LLR coverage is low – the ratio declined in H1 23 due to write-offs – but this is mitigated by the sizeable collateral held by the Bank (against not just impaired loans but the entire loan book), the steady, though slow, pace of recoveries through court action and, lastly, the large capital base and good operating profits that provide sizeable additional buffer. Furthermore, Stage 2 loans are moderately low and other asset items on the balance sheet have minimal or no Stage 2 and Stage 3 exposures. We expect lending volumes to rise this year as the economic recovery gains momentum, but credit growth is likely to be modest at best.

NBQ's profitability ratios have historically been strong thanks to the Bank's wide net interest margin (NIM), good cost efficiency ratios and low impairment charges. The strong growth in operating income and operating profit in 2022 and H1 23 was mainly due to a widening NIM reflecting interest rate hikes. The Bank's wide NIM is mainly attributed to its low funding cost (one of the lowest in the banking sector), which in turn reflects its large capital base, almost negligible borrowings, and a moderately good CASA ratio. Rising interest rates therefore have a strong positive impact on income generation. We expect good growth in net interest income (NII) this year, although the rate of growth may slow towards the end of the year as the frequency and magnitude of rate hikes reduce. NBQ's fee income is not high, and investment gains and miscellaneous income fluctuate y-o-y. The operating cost base is low and the growth in income has strengthened the cost to income ratio in recent periods. ROAA has been high and rising in recent years due to increasing operating profits and low net impairment charges. NBQ's ROAA was the highest in the banking sector in 2021 and 2022. The Bank does not have diversified sources of income and is dependent on corporate banking activities. However, key profitability metrics have shown resilience even through difficult periods over many years.

NBQ's high capital base supports its overall strong liquidity giving it one of the lowest net loans to stable funds ratios in the banking sector. Deposit growth in recent years along with the decline in lending have led to improvements in the Bank's already good loan-based liquidity ratios in recent years. CASA is at a moderately good level, although there was a decline in the CASA ratio in 2022 and H1 23 with higher interest rates encouraging depositors to shift to time deposits. In common with most banks, customer concentration in the deposit base is high. However, major funding sources, including related party and government deposits, have proved to be stable even during stressed liquidity conditions in the past.

Capital ratios are very strong and among the best in industry. Capital is also only slightly impaired by unprovided NPLs. While dividend payouts have been generous, this is acceptable given the high capital ratios. The Basel III leverage ratio is also very high. Capital is more than sufficient to power a substantial increase in risk weighted assets (RWAs). The Bank can also raise debt capital in the future if required. Capital can also be increased by reducing dividend payouts as has been done in the past. NBQ's capital ratios are expected to stay strong given its low and conservative risk appetite and strong earnings.

Rating Outlook

The Stable Outlook reflects our expectation that the ratings are unlikely to change over the next 12 months. We expect the economic recovery currently underway to have a favourable impact on NBQ's financials.

Rating Dynamics: Upside Scenario

An upgrade in the LT FCR and BSR or a change in the Outlook to Positive over the next 12 months would require a strengthening in the Bank's standalone profile. This could come from a significant improvement in asset quality, lower customer concentrations, a more diversified business base and a larger balance sheet.

Rating Dynamics: Downside Scenario

Though a remote possibility, a one-notch downgrade of the LT FCR and BSR or a change in the Outlook to Negative would be likely in the event of a deterioration in the Bank's credit profile. 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.

DETAILED RATING ANALYSIS

Business Model and Strategy

CI View

The Bank has followed a very conservative strategy since the global financial crisis led to sizeable asset impairments. Preserving capital and liquidity have been management's overarching objectives since that year. Thus far, the Bank has been able to overcome the disadvantages of a small customer franchise and limited business diversification to generate good earnings every year. However, its share of the business in the UAE has shrunk and rising competitive pressures in a consolidating banking sector could adversely impact its franchise over the long term.

Business Model

NBQ is a small bank with a just 0.5% share of the total assets of the UAE banking sector. It provides a range of corporate, commercial and retail banking services. Its activities are primarily UAE-based and the Bank has no physical presence outside the country. Dubai is the Bank's principal market and accounts for a little less than two-thirds of its gross loans. NBQ provides working capital loans, trade finance, project finance and syndicated loans. Corporate and commercial banking activities make major contributions to both sides of NBQ's balance sheet. The Bank's corporate banking business is divided into two customer segments: medium-to-large companies and small companies. The Institutional Banking Division handles investment banking, financial institutions, debt capital market, treasury and international banking functions. While it offers a range of retail products, both conventional and Islamic, these are not significant income earners. NBQ's revenue streams tend to be narrow given the limited business diversification and there is some concentration in the real estate sector as well.

Franchise Strength

NBQ's customer base is small compared to the larger banks in the country. However, it has built a fairly loyal clientele among small, medium-sized and large entities in the services and real estate sectors. It operates a network of 11 branches, which is fairly large given the small size of the Bank's balance sheet. Despite its size and limited franchise strength, CI believes that there are opportunities for the Bank to grow if management's risk appetite increases. NBQ has been able to generate good earnings over the last few years, while at the same time conserving its capital, overcoming the disadvantages of size and low growth rates (at least when compared with other small banks in the country).

Management and Strategy

The Bank long-standing top management team has many years of experience working in the region and a solid track record of generating good earnings. The current CEO was appointed in 2021. A good second line of management is in place. Current strategies focus on growing the wholesale banking business with a view to diversifying the portfolio and reducing concentration in real estate. There are plans to increase exposures to government-related entities (GREs) and to the manufacturing and contracting sector. The Bank will continue to retain a presence in the retail sector and could grow this business this year. A major IT project is underway which will have a significant impact on the Bank's trade finance and cash management businesses. The liabilities strategies focus on growing CASA balances and reducing concentration. For many years the Bank has adopted a cautious stance with management focusing primarily on conserving liquidity and maintaining a high capital base. While the overall conservative outlook is unlikely to change significantly, new relationship managers have been recruited to drive loan growth. The Bank also aims to book short-term syndicated and bilateral loans and will invest in high-yielding securities for shorter tenors in view of the interest rate hikes. Cross-selling of retail, treasury and investment banking products to corporate and commercial relationships continues to be emphasised.

Ownership and Governance

CI View

The Bank can rely upon the principal owners to provide ordinary support. Risk standards are well established and there are no major concerns here. Disclosures in the interim financials are good.

History and Ownership

Main Shareholders (%)	
Government of Umm Al Quwain	30.0
Salem Abdullah Salem Al-Hosni	12.7
Group of Abdul Wahed Al Rostamani LLC	10.1
Barah Investment LLC	10.0

The National Bank of Umm Al Qaiwain (NBQ) was established in 1982 by the ruler of Umm Al Quwain (UAQ), a small emirate in the northern part of the country with limited natural resources and largely dependent on federal support. The Bank's principal shareholders are the government of UAQ (30%) and major UAE-based business groups. The shares of the principal stakeholders have not changed for some years. The chairman of the board is the crown prince of the emirate of Umm Al Quwain. The government of Umm Al Quwain provides substantial funding support to the Bank – it is a major depositor – and is likely to extend capital support when required. In line with the central bank's new guidelines, NBQ has inducted three independent directors on the board.

Risk Management and Control

Risk standards are well established and there are no major concerns here. Underwriting standards are conservative. The Bank uses the 'three lines of defence' approach to its risk management architecture. The credit risk department monitors risks at the micro and macro levels and handles all control functions. The Bank has a rating system in place to assess the creditworthiness of borrowers. Credit is extended mainly against collateral. The Bank prefers to deal with borrowers who have multiple sources of income. Management of stressed accounts is centralised. NPLs are defined as loans in which there is loss due to default or are past due for 90 days or more.

Accounting, Disclosure and Transparency

The 2022 accounts were audited by Ernst & Young in accordance with International Standards on Auditing. The auditor's report is unqualified. The financial statements have been prepared to International Financial Reporting Standards (IFRS). The consolidated accounts include the financials of the Bank's small marketing management subsidiary. In addition to the disclosures in the financial statements, NBQ has provided CI with additional information on key areas. The adoption of new standards last year had no material impact on the financial statements. The following analysis is also based on the Bank's unaudited, but auditor reviewed, H1 23 financials.

Risk Profile and Risk Mitigation

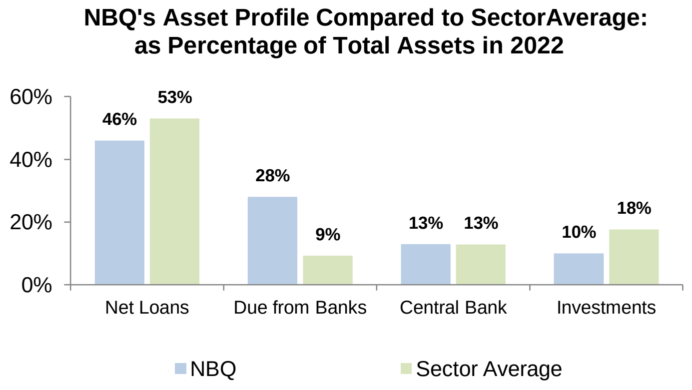
CI View

While key asset quality ratios continue to be weaker than peer group average, this is mitigated by the sizeable collateral held by the Bank (against not just impaired loans but the entire loan book), the steady, though slow, pace of success in recovering legacy loans through court action, and, lastly, the large capital base and good operating profits that provide sizeable additional buffer. We expect the declining trend in gross loans to be reversed this year as the economic recovery gains momentum, but credit growth is likely to be modest at best.

Balance Sheet Structure and Concentration Risk

Following several years of balance sheet contraction due to a steadily declining loan portfolio which in turn reflected low risk appetite, NBQ's total assets rose by 4% in 2022. This was mainly due to higher central bank balances, due from banks and securities, while net loans declined by 5%. In Q1 23 total assets rose by 4% q-o-q due to higher central bank balances while net loans continued to decline, albeit only marginally. NBQ's share of banking sector assets was a very low 0.5% at end-2022.

We note that the Bank's net loans to total assets ratio (46% in 2022) is well below the sector average (53%) (see adjacent chart). This is largely because loans to banks are reported under due from banks, which is a fairly large portfolio (28% in 2022), compared to peers (9% average). The Bank also deploys its excess liquidity in bank deposits. NBQ maintains a moderately low portfolio of investment securities (comprising mainly equities) compared to peers. Central bank balances representing 13% of the balance sheet total form the bulk of its liquidity buffer. Financial assets accounted for a sizeable 96% of total assets at end-2022, unchanged from the previous year. The balance sheet structure changed slightly in H1 23, with a decline in due from banks offset by higher central bank balances.



Bank deposits are of good quality with no Stage 2 or 3 exposures. Around 31% of these balances represented loans to banks while the balance comprised demand and term deposit placements. Bank exposures were mainly to UAE entities (64% in 2022) and to banks rated 'BBB' and higher by external agencies (around two-thirds).

The investment portfolio has increased over the years, but at 10% of total assets in 2022 it was below levels maintained by peer banks. The Bank's portfolio comprises mainly equities (73% in 2022) of UAE banks, public sector entities and blue-chip private sector companies. The remaining 27% were debt securities. Investments are primarily fair valued through other comprehensive income (FVOCI) (72% in 2022) and amortised cost (27%). The Bank recorded fair value gains in OCI in 2022 (AED60mn or 14% of total comprehensive income) and a small loss in H1 23 (AED52mn). The equity portfolio has generated good dividend income for the Bank over the years.

Gross loans shrank by 5% in 2022 mainly due to a fall in exposures to the real estate sector, in line with management's objective to reduce sector concentration and diversify the credit portfolio. However, real estate and construction sector exposures led the growth in lending in H1 23 and accounted for a substantial 46% of gross loans (see adjoining table). There was also an increase in loans to the trade sector while other sectoral exposures declined. The Bank intends to grow its exposures to GREs this year along with contractor financing and loans to manufacturing. Its lending activity is mainly in Dubai, Sharjah and Al Ain. Personal loans, which are currently very small (5.5% of gross loans in H1 23), are likely to rise this year with the focus on mortgage lending to UAE nationals.

Loans by Sector		
H1 23	**AEDmn**	**% of Total**
Real Estate/ Construction	3,074	46.3
Wholesale/Retail Trading	1,177	17.7
Personal Loans	367	5.5
Financial Institutions	248	3.7
Manufacturing	360	5.4
Transport	157	2.4
Government	178	2.7
Services and Others	1,081	16.3
Gross Loans	**6,390**	**100.0**

Underwriting standards are stringent, and loans are typically given to customers with multiple sources of income. The Bank has been booking loans over the last several years, but repayments have exceeded credit disbursals. Given that there were over AED1bn loan commitments outstanding at end-March 2023, we expect some loan growth to take place this year, especially since loan demand is rising with the improvement in the local economy. However, we expect NBQ to continue to adopt a very cautious attitude to loan growth.

NBQ's gross loans are concentrated primarily in Dubai (70% in Q1 23), which also accounts for a sizeable portion of the non-oil GDP of the country. There are no overseas exposures. The majority of loans (79% at end-2022) have maturities of over one year.

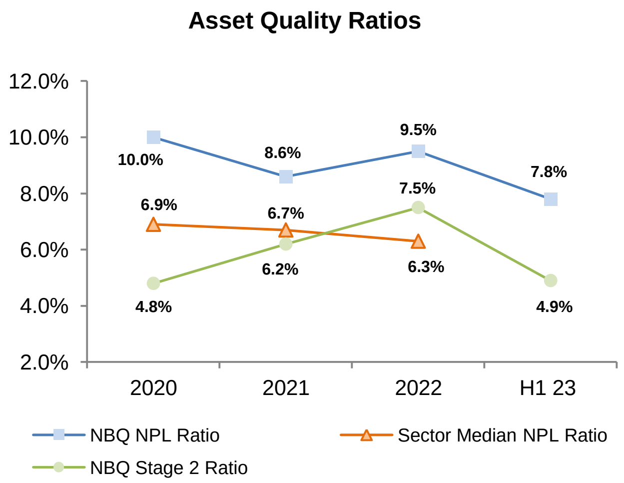
Related party exposures are low – 0.2% of capital in H1 23. Moreover, related parties are major placers of funds with the Bank – AED3.7bn, representing 45% of customer deposits at the end of the half year.

In common with other banks in the region, customer concentration in the funded credit book is high. Total funded exposure to the 20 largest customers amounted to 45% of total loans in Q1 23 (net of interest in suspense).

The contingent account portfolio is fairly large and consists mainly of guarantees issued on behalf of customers and loan commitments. However, contingent balances have declined as a percentage of total on-balance sheet assets over the years to 23% in H1 23, representing a decline in real estate transactions.

Asset Quality and Credit Risk

The NPLs to gross loans ratio has fluctuated between 10% and 8% over the last few accounting periods (see adjacent chart). NPLs rose by 5% in 2022 but declined by 17% in H1 23 partly due to write-offs. The Bank's 2022 NPL ratio was much higher than the sector median (see adjacent chart) but not too different from the average for small banks (8.4%).



The NPL ratio is high partly because of the steady decline in the denominator over the last several years. We expect the ratio to move within a 7-8% range this year, unless loan growth accelerates. The Bank is still fighting cases in the courts relating to its legacy impaired loans. It has had some success over the years – particularly in 2021 – but overall, the process has been very time consuming.

NBQ's Stage 2 loans to gross loans ratio rose last year to 7.5% but declined in H1 23 to 4.9%; the sector average in 2022 was 7%. Loans past due for 90 days or less are a negligible portion of gross loans.

Due from banks and investment securities are all classified as Stage 1. Off-balance sheet items have low Stage 2 and Stage 3 items.

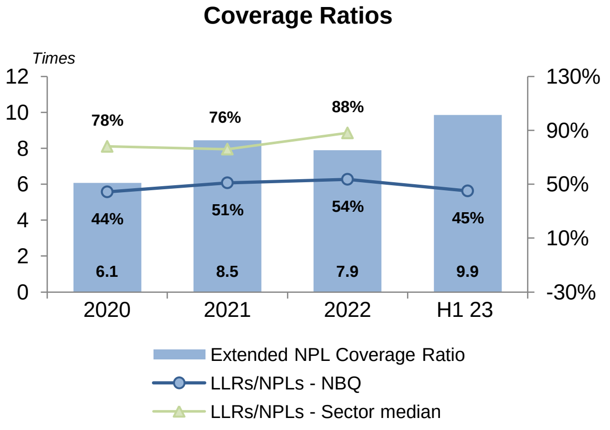
Market Risk

The Bank has some exposure to equity price risk. Data on equity price risk sensitivity provided by the Bank showed that if equity prices were 20% lower at the reporting date, and other variables held constant, the consolidated statement of comprehensive income would have decreased by AED191mn (total comprehensive income was AED424mn in 2022). Given the Bank's large capital base, this is unlikely to significantly impact its overall financial position. Since the AED/USD peg has not changed for decades, exposure to currency risk is limited. Interest rate risks are low and, according to the Bank's sensitivity analysis, an increase in interest rates would lead to a rise in NII.

Credit Loss Absorption Capacity

NBQ's coverage ratio has been well below the peer group average over the years. LLR coverage improved last year to a still low 54%, but declined slightly in H1 23 to 45% due to the write-off of fully provided loans. Including impairment reserves in capital being the excess of provisions calculated as per central bank rules over IFRS, the coverage ratio was 60% in H1 23.

Coverage ratios are low because of the substantial collateral cover held by the Bank. Nearly all lending is backed by tangible collateral – the total value of collateral as a percentage of Stage 1 loans and non-funded exposures was 140% at end-2022.



Collateral and specific provisions together covered 183% of NPLs at end-2022 and 254% in H1 23. Management monitors the value of collateral closely and, where necessary, additional collateral is requested from borrowers. While enforcing security can be very time consuming in the UAE (often taking several years), the Bank has aggressively pursued recovery of NPLs via collateral sales in the courts and has been successful. At end-2022, properties acquired in settlement of debt amounted to AED189mn, up from AED155mn in 2021 and AED64mn in 2020. The Bank earns rental income from these properties.

NBQ is confident of recovering much of its impaired loans and it looks to collateral as a fall back in case of default. The Bank's *modus operandi* is to encourage delinquent customers to sell their properties. In other cases, the threat of collateral enforcement is usually enough to encourage borrowers to repay overdue debts. Court cases are filed in case of a dispute. CI does not consider collateral security a sufficient substitute for cash provisions. However, the Bank has a large capital base that provides additional cover. Tier 1 capital and provisions together covered NPLs 9.9 times in H1 23 (see table below). The Bank is also able to absorb high provision charges, if necessary, given its good operating profitability.

Asset Quality, Selected Metrics
(% unless stated otherwise)

	H1 23	2022	2021	2020
NPL Ratio	7.8	9.5	8.6	10.0
NPL Coverage Ratio	45.0	53.6	51.0	44.3
Loan-loss Provision Expense to Gross Loans	1.2	0.3	-0.2	1.3
Extended NPL coverage ratio	985.4	789.7	844.9	608.3

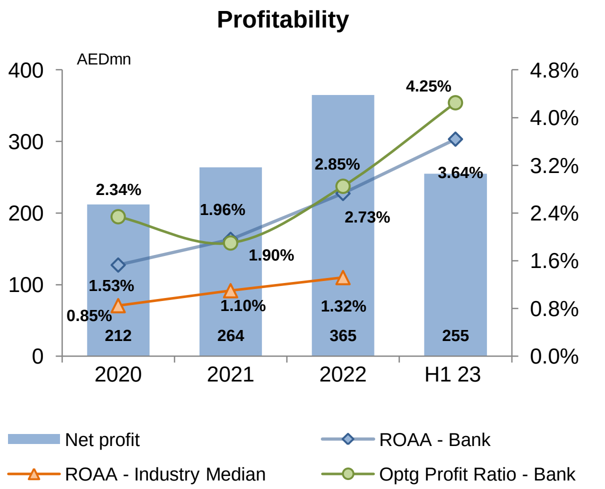
Earnings Strength

CI View

Profitability metrics are strong and have shown resilience through difficult periods. We expect higher interest rates to boost income, while recoveries could keep impairment charges low. CI expects the Bank to continue to generate reasonably good earnings in the coming years, but over the long term this could become more challenging given rising competitive pressures.

Profitability and Efficiency

Rising interest rates in 2022 contributed significantly to the strong growth in operating income and operating profit that year, despite the y-o-y decline in credit volumes. Operating income rose by 36% while operating profit increased by 49%. This is attributable to the Bank's wide NIM which, at nearly 3.0% in 2022, was a good 50bps higher than the sector average. This in turn reflects NBQ's low cost of fund (0.8% in 2022) compared to the peer group (1.5%). The Bank's funding cost has historically been lower than the peer group due to its high capital base, minimal borrowings on the balance sheet and a good low-cost deposit base. In previous years, low interest rates and a declining credit portfolio had contributed to the steady fall in income.



While changes in interest rates play an important role in the Bank's revenue growth leading to some fluctuation in income, we note that the operating profitability ratio has been at a good level (1.90%) even during a difficult year like 2021 (see adjacent chart). The operating profit to average assets ratio rose to 2.85% in 2022 and there was a further improvement in H1 23 to a high 4.25% due to a 117bp increase in the NIM (H1 ratios are annualised). The Bank is expected to report a good increase in NII in 2023 even if the loan book does not expand. However, since interest rates are not likely to rise as fast as in 2022, NII growth this year could be slower than in the previous year.

The Bank's non-II also contributes to its high operating income base. Although not as large as those of other banks with a high level of Dubai-based business, NBQ's non-II was a moderate 1.0% of average assets in 2022. Fee and commission income has been falling y-o-y due to slowing lending activity and accounted for a low 0.3% of average assets in 2022. Investment income has been fairly stable over the years (also at 0.3% of average assets) and consists mainly of dividend income. There has also been a reasonable amount of recoveries from loans that have been written off (AED45mn in 2022, AED28mn in 2021).

The Bank's operating profitability also benefits from its low operating cost base. Although operating costs rose by 13% last year, the cost to income ratio declined to 29% from 35% in the previous year – this is below the sector median ratio of 35%. Operating costs as a percentage of average assets was 1.2% at NBQ last year – the average ratio of small banks in the country was 1.6%.

ROAA has historically been high. It rose from 1.96% in 2021 to 2.73% in 2022 and to 3.6% (annualised) in H1 23. ROAA is boosted not only by rising income but also low impairment charges and recoveries. In 2022, the net charge was a low AED16mn or just 0.1% of average assets and in 2021 there was a net write back of provisions of AED8mn. The net impairment charge rose to AED42mn in H1 23 reflecting provisioning for assets moved to Stage 3 from Stage 2 during the half year, but the net charge to operating profit ratio remained low at 14%.

Earnings Quality and Stability

The Bank's business base is not diversified; it continues to earn the bulk of its income from corporate banking activities. Also interest income is its main source of revenue and fee and commissions earnings have tended to be low especially compared to the larger banks in the country. Additionally, its equity holdings have a moderate impact on total comprehensive income, both via dividend income earned and fair value gains and losses through OCI, which could give rise to some volatility. That said, CI notes that the Bank's income generation has been tested through several economic cycles and its management has built a good track record of delivering strong results every year. However, over the long term, it may become more challenging for NBQ to grow its business and stay relevant. The Bank's future growth is also closely linked to the development of the UAE economy, and particularly that of Dubai.

Earnings and Profitability, Selected Metrics
(% unless stated otherwise)

	H1 23	2022	2021	2020
Return on Average Assets (ROAA)	3.64	2.73	1.96	1.53
Operating Income to Average Assets	5.35	4.01	2.92	3.42
Operating Profit to Average Assets	4.25	2.85	1.90	2.34
Net Interest Margin (NIM)	4.15	2.98	2.06	2.38
Non-interest income to Gross Income	22.4	25.5	29.4	30.3
Cost-to-Income Ratio	20.6	28.9	34.8	31.6

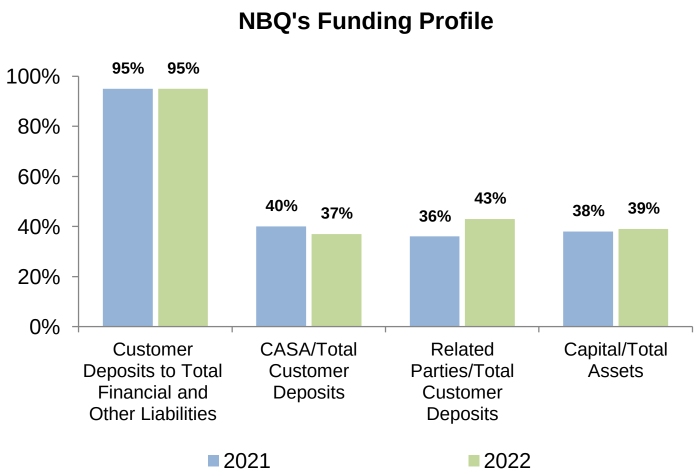
Funding and Liquidity

CI View

NBQ's high capital base supports its overall good liquidity. Key liquidity ratios continue to be strong. In common with most banks, there is some customer concentration in the deposit base, but the major funding sources, including related parties, have proved to be fairly stable in stressed conditions in the past.

Funding Diversification and Stability

The Bank has a simple funding structure, with customer deposits accounting for nearly 95% of total financial and other liabilities and 58% of total assets. The Bank's large capital base (39% of total assets) provides substantial funding support, while borrowings and short-term interbank liabilities are very low. This structure has not changed for many years. In the past, however, the Bank had raised money from the international markets.



The adjacent chart highlights the major features of NBQ's funds base, i.e. sizeable capital, good CASA ratio and high stable deposits from related parties. The Bank has a high percentage of deposits with medium-term tenors (37% at end-2022), unlike most other banks in the country, which have almost no deposits in the over-one-year-tenor category.

Customer deposits had declined over the years as the Bank did not actively seek deposits due to the contraction in lending. However, deposits rose by 2% in 2022 and by 5% in H1 23. Over the years, the Bank had built its CASA ratio to a moderately good level (40% at end-2021). However, that ratio slipped to 37% in 2022 and 35% in H1 23, with depositors lured to time deposits by rising interest rates. While the CASA ratio is not as high as those of the larger banks in the country it is on par with the ratios of small banks.

As a small bank with a limited branch network, NBQ depends partly on wholesale deposits placed by companies and institutions. The 20 largest depositors accounted for a substantial 66% of total customer deposits in Q1 23; but excluding deposits placed by the sovereign, which accounted for six of the top 20 names, the 14 largest depositors accounted for just 11% of total customer deposits. Deposits placed by the government and public sector entities tend to be sticky.

Liquidity Risk

Liquidity ratios continue to be strong. The loan-to-deposit ratio has strengthened over the years to 77% in H1 23 from 79% in 2022 and 86% at end-2021 – this was largely due to the decline in loans. The Bank's ratio was better than the sector median ratio of 83% last year. Given the high capital base, the Bank's net loans to stable funds ratio may be a more accurate measure of liquidity. That ratio also strengthened in 2022, to 47% from 52% in the previous year. The sector average was 63% last year. NBQ's stable funds consist only of customer deposits and capital with, therefore, very little, if any, refinance risk. CI expects the Bank to maintain strong liquidity ratios going forward.

The Bank has a good stock of liquid assets in the form of cash and balances, which accounted for around 13% of the balance sheet total at end-2022. However, the net broad liquid asset ratio, which includes net interbank assets in the numerator, was much higher at 40%. Additionally, the Bank also holds equity and debt securities which amounted to nearly 10% of total assets; the bulk of these securities can be disposed of quickly in case of an emergency. Asset/liability maturity gaps have been low across all maturity periods over the last few years due to the existence of sizeable medium-term deposits. NBQ's maturity gaps continue to be far smaller than those of many of its peers.

Funding and Liquidity, Selected Metrics (% unless stated otherwise)				
	H1 23	**2022**	**2021**	**2020**
Loan-to-Deposit Ratio	77.4	79.4	85.6	92.9
Net Loans to Stable Funds	47.0	47.3	51.7	58.2
Net Broad Liquid Asset Ratio	40.5	40.2	37.1	32.9
Wholesale Funding Ratio	0.0	0.0	0.0	1.5

Capitalisation and Leverage

CI View

The Bank is very strongly capitalised and its key ratios are the best in the industry. Capital is also large enough to comfortably absorb unprovided NPLs. NBQ has paid generous dividends in recent years but despite that its capital has grown at a good pace reflecting good income generation. NBQ's capital ratios are expected to stay strong given its low risk appetite and high net earnings.

Capital Quality and Adequacy

Capital ratios have been above 40% between 2020 and 2022, and prior to that they were above 30%, reflecting management's cautious stance for many years. The CAR was a very high 44.3% in 2022, improving to 46% in H1 23 due to strong earnings. The Bank's CET 1 and Tier 1 ratios are also high and differ only very slightly from the CAR (see table below). NBQ has no Tier 1 debt capital and its Tier 2 funds consist of general provisions and fair value reserves. Capital ratios are well above regulatory requirements (minimum 13% CAR) and apart from being significantly better than the peer group average, they are also the highest among UAE banks. The Bank has more than enough capital to support a significant increase in RWAs; however, given its still low risk appetite and cautious outlook, this is unlikely to happen, and we expect key ratios to continue to remain strong in the intermediate term.

Equity capital rose by nearly 6% in 2022, due to good net profit and some unrealised gains from the investment book. In H1 23, capital rose only marginally due to a dividend payment (AED200mn). NBQ's Basel III balance sheet leverage ratio was a strong 29% at end-2022. Capital is only slightly impaired by unprovided NPLs.

Capital Flexibility

NBQ has primarily built its capital over the years from retained earnings, and shareholders had last injected equity in 2008. While NBQ's dividend payout ratio has been high – 55% in 2022 and 56% in 2021 – this is acceptable given that it has more than adequate capital to support its balance sheet. The Bank can raise debt capital in the future if required. Capital can also be increased by reducing dividend payouts as has been done in the past.

Capital Adequacy and Leverage, Selected Metrics (% unless stated otherwise)				
	H1 23	**2022**	**2021**	**2020**
Common Equity Tier 1 Ratio	44.9	43.1	43.5	40.3
Tier 1 Ratio	44.9	43.1	43.5	40.3
Capital Adequacy Ratio	46.0	44.3	44.7	41.5
Internal Capital Generation	-	4.3	2.5	0.2
Dividend Payout Ratio	-	54.9	56.0	69.8

Operating Environment

Operating Environment Risk Anchor (OPERA)

The OPERA for UAE is ‘bbb’ (indicating modest risk). This reflects the relative dependence of the economy on hydrocarbons, moderate institutional strength and limited monetary policy flexibility as the AED is pegged to the USD. Moreover, the economic risk is partially mitigated by the federation support of the wealthy emirate of Abu Dhabi to the federation and the availability of a very large buffer of external assets under the management of ADIA. The UAE banking sector remained strong in 2022 fuelled by improving macroeconomic performance and high hydrocarbon prices. The banking system is sound at present, with high levels of capitalisation and moderately low NPLs. Sovereign support in case of distress is available and local banks are mostly government-owned, whether directly or indirectly. Most banks rely partly on government funding and GRE deposits, and the customer deposit base is characterised by a high level of large-value deposits leading to significant customer concentrations in the funding structure. Credit portfolios have some sector concentration to real estate and construction, and customer concentration levels are higher than globally accepted levels. Central bank supervision standards have strengthened, and the sector is on the whole reasonably well regulated.

Economic and Financial Conditions

Economic performance is expected to remain upbeat in the short to medium term, fuelled by a recovery in the non-oil sectors and reform implementation under the UAE Strategy for the Future. Real GDP is expected to moderate to 3.5% in 2023 (from 7.4% in 2022) with the non-hydrocarbon sectors expanding briskly. Real output growth is expected to average 4% in 2024-25, reflecting solid non-hydrocarbon growth. The UAE holds the seventh largest proven oil and gas reserves in the world and oil still accounts for about 26% of GDP and around 40% of consolidated government revenues. However, the economy is being diversified. An ambitious reforms programme launched in 2016 aims to strengthen the private sector, improve labour laws, encourage inflows of human and financial capital to the UAE and lower economic risks stemming from the dependence on the oil sector. In a first, corporate entities are to be taxed from 2024 – this will replace a labyrinth of business fees that companies are paying. Notwithstanding the favourable growth outlook, risks could stem from uncertainties relating to spillovers from slowing global economies.

The local economy is resilient due to the country’s comparatively diversified business base and the general ease of doing business. The housing and real estate market, which had faced headwinds for several years is seeing a revival with the increase in transaction volumes, property prices, rental yields and investment activity. The outlook for the sector is positive for 2023. Likewise, the construction sector, which had problems in the years leading up to 2020, experienced a small recovery in 2022. In the coming years the construction sector’s growth will be driven by large-scale projects in the oil, gas, power, transportation and infrastructure sectors.

UAE’s external position continues to benefit from a large stock of external assets. There is limited disclosure on the assets of sovereign wealth funds, but it is estimated that the Abu Dhabi Investment Authority (ADIA), the largest of the UAE funds, had about USD790bn under management in 2022. CI expects ADIA’s assets to be around 1.84 times the size of the country’s total external debt stock in 2023. While the net creditor position of the country cannot be taken as a solvency risk indicator for individual emirates, CI expects that Abu Dhabi – being the wealthiest emirate – would provide financial assistance to the federal government, including the UAE central bank, in the event of need.

At present, consolidated government refinancing risks are low given the relative size of the budget surplus. Although Abu Dhabi and Dubai have not tapped international markets since 2021, their access likely remains strong. The federal government has limited financing needs but is expected to continue issuing local currency debt in 2023 as part of efforts to build a domestic yield curve. Contingent liabilities are deemed moderate; however, tighter local and international monetary policies could lead to higher refinancing risks for government related entities (GREs). Dubai’s GREs are the most exposed to refinancing risk. According to the IMF, the maturing debt of GREs is estimated at USD16.8bn (3.4% of GDP) in 2023, with the stock of UAE non-bank GRE debt estimated at 27.6% of GDP.

Industry Structure and Performance

The UAE banking sector is poised for growth this year on the back of economic expansion which would partly be driven by increased spending by the major emirates. Banking sector assets (of 61 licensed banks) expanded by 10.5% y-o-y in 2022 to AED3.67tn. Gross loans rose by 5% y-o-y, significantly up from just 0.8% in 2021 – the growth was led by retail loans and both public and private sector credit. Asset quality ratios have improved gradually in recent years but the NPL ratio was still high at 6.3% at end-2022. Banks have made sizeable provisions but the LLR coverage ratio of 88% in 2022 remains below the historical average for UAE banks. CI Ratings expects asset quality ratios to strengthen gradually over the next few years. High customer concentration levels and sector concentration in real estate and construction are credit challenges for the sector.

Banking sector profits continued to rise in 2022 reflecting wider NIMs and increased business volumes, but average ROAA remained below the pre-Covid level. Further widening of margins, coupled with higher loan growth and possibly lower provisions would boost profitability for the sector in 2023. Capital ratios remain strong with the average CAR at 17.3% at end-2022 and the CET 1 ratio at 14.4%. There is ample liquidity in the banking sector – bank deposits rose by 11.3% y-o-y in 2022 – and key ratios remain sound; the loan-to-deposit ratio eased further to 85% in 2022 from 90% in 2021.

Regulatory Environment

The regulator is proactive and has been very supportive of the banking sector over the years. Its monetary stimulus programme in 2020 was helpful in limiting the impact of the economic lockdowns that year. Prudential requirements were also eased for banks. These stimulus measures have since been rolled back. In January 2023, the central bank issued new and tighter guidelines to combat money laundering. From January 2021 the central bank began issuing monetary bills which are auctioned and traded. The objective is to develop the secondary market for AED denominated securities, contribute to the establishment of a yield curve and provide a stable collateralised source of funds to banks. In December 2021, the central bank developed new standards for real estate lending which defined risks and measures and monitors concentration levels; a bank’s exposure to real estate is presently capped at 30% of its RWAs. The central bank has strengthened its regulatory oversight in recent years, pushing some of the local banks to recognise impaired loans early and make more aggressive provisions.

The banking law was revamped in 2018, giving more power to the central bank and setting out clear guidelines for financial institutions regarding promotions, advertising and communications. Corporate governance standards have been strengthened over the years. There are four systemically important domestic banks in the country – First Abu Dhabi Bank, Emirates NBD, Dubai Islamic Bank and Abu Dhabi Commercial Bank.

Extraordinary Support

Official Support

NBQ can expect extraordinary support from the UAE government, which has the financial capacity and willingness to provide timely assistance in case of need. Support was demonstrated in 2009 when the central bank provided liquidity in the form of term deposits to all banks in the country, which were later converted into subordinated debt. We also expect the government of Umm Al Quwain, the Bank’s largest shareholder, to extend support if required.

KEY PERFORMANCE METRICS

NATIONAL BANK OF UMM AL QAIWAIN

	(All figures are percentages, unless otherwise stated)	H1 23	2022Y	2021Y	2020Y	2019Y
A	**SIZE FACTORS**					
1	Total Assets (AED000)	14,061,504	13,605,122	13,142,025	13,546,044	14,297,572
2	Total Assets (USD000)	3,827,926	3,704,090	3,578,008	3,688,005	3,892,614
3	Employees (FTE)	-	-	-	-	-
B	**ASSET QUALITY**					
4	Total Assets Growth Rate	3.4	3.5	-3.0	-5.3	-2.5
5	Customer Loan Growth Rate	0.9	-4.5	-13.8	-7.5	-7.5
6	Customer Deposit Growth Rate	5.3	2.1	-6.4	-9.0	-7.4
7	NPL Growth Rate	-16.8	5.2	-25.6	5.7	9.6
8	NPL Ratio	7.8	9.5	8.6	10.0	8.7
9	NPL Coverage Ratio	45.0	53.6	51.0	44.3	50.2
10	Extended NPL Coverage Ratio	985.4	789.7	844.9	608.3	639.8
11	Unprovided NPLs to Total Equity	5.3	5.4	5.7	9.4	7.9
12	Loan Loss Provisioning Expenses to Gross Loans	1.2	0.3	-0.2	1.3	1.0
13	Government Bond Exposure	0.0	0.0	0.0	0.0	0.8
14	Related Party Exposure	0.2	3.5	5.7	7.3	17.0
15	Off Bal Sheet Exposures to Total Assets	22.6	24.0	26.9	27.0	35.6
C	**EARNINGS AND PROFITABILITY**					
16	Return on Average Assets (ROAA)	3.64	2.73	1.96	1.53	2.93
17	Return on Average Risk-Weighted Assets (RWAs)	4.81	3.35	2.38	1.83	3.49
18	Operating Profit (pre-impairment) to Average Assets	4.25	2.85	1.90	2.34	3.47
19	Operating Income to Average Assets	5.35	4.01	2.92	3.42	4.45
20	Net Interest Margin (NIM)	4.15	2.98	2.06	2.38	3.47
21	Cost of Funds (COF)	1.63	0.83	0.61	0.99	1.13
22	Interest income on Average Assets	5.11	3.46	2.43	3.01	4.21
23	Non-Interest Income to Gross Income	22.4	25.5	29.4	30.3	22.1
24	Net Fee and Commission Income to Non-Interest Income	18.7	26.5	37.9	51.5	54.9
25	Cost to Income Ratio (CIR)	20.6	28.9	34.8	31.6	22.1
26	Loan Loss Provisioning Expenses to Operating Profit	13.9	4.8	-5.9	31.7	16.5
27	Total Impairment on Financial Assets to Operating Profit	13.9	4.1	-3.2	34.6	15.4
28	Return on Average Equity (ROAE)	9.7	7.0	5.4	4.6	9.3
D	**FUNDING AND LIQUIDITY**					
29	Customer Deposits to Total Liabilities	95.2	95.0	95.2	93.0	94.8
30	Loan-to-Deposit Ratio (LDR)	77.4	79.4	85.6	92.9	91.5
31	Net Loans to Stable Funds	47.0	47.3	51.7	58.2	59.9
32	Wholesale Funding Ratio	0.0	0.0	0.0	1.5	0.0
33	Short-term Wholesale Funding Ratio	-	-	-	-	0.0
34	Net Stable Funding Ratio (NSFR)	-	-	-	-	-
35	Liquidity Coverage Ratio (LCR)	-	-	-	-	-
36	Liquid Asset Ratio	19.1	12.7	11.0	11.2	12.4
37	Net Broad Liquid Asset Ratio	40.5	40.2	37.1	32.9	31.9
38	Interbank Ratio	-	46,856,025.0	-	11,788,516.0	659,754.6
39	FX Assets to FX Liabilities	-	-	-	-	-
E	**CAPITALISATION AND LEVERAGE**					
40	Common Equity Tier 1 (CET 1) Ratio	44.9	43.1	43.5	40.3	37.1
41	Tier 1 Ratio	44.9	43.1	43.5	40.3	37.1
42	Total Capital Adequacy Ratio (CAR)	46.0	44.3	44.7	41.5	38.2
43	Basel III Leverage Ratio	-	29.1	30.9	-	-
44	Balance Sheet Leverage	38.2	39.2	38.4	34.7	33.4
45	RWA Density	-	78.1	84.7	82.1	83.7
46	Internal Capital Generation	1.0	4.3	2.5	0.2	5.0
47	Dividend Payout Ratio	-	54.9	56.0	69.8	47.9

Note: Ratios annualised where appropriate.

Sources: CI Ratings, Bank financials, S&P Global Market Intelligence (SNL financial data).

SUMMARY FINANCIALS

BALANCE SHEET - ASSETS (AED 000)	H1 23	2022Y	2021Y	Growth (%)		% of Total Assets	
End of Period Date	**30/06/2023**	**31/12/2022**	**31/12/2021**	**30/06/2023**	**31/12/2022**	**30/06/2023**	**31/12/2022**
Cash and Balances with Central Banks	2,679,568	1,724,400	1,451,384	55.4%	18.8%	19.1%	12.7%
Due from Banks	3,019,668	3,748,482	3,422,563	-19.4%	9.5%	21.5%	27.6%
Gross Loans to Customers	6,641,968	6,580,088	6,890,113	0.9%	-4.5%	47.2%	48.4%
o/w Non-performing Loans	518,273	622,672	591,737	-16.8%	5.2%	3.7%	4.6%
Loan Loss Reserves (-)	233,433	333,845	301,559	-30.1%	10.7%	1.7%	2.5%
Net Loans to Customers	6,408,535	6,246,243	6,588,554	2.6%	-5.2%	45.6%	45.9%
Total Securities	1,418,426	1,338,077	1,132,684	6.0%	18.1%	10.1%	9.8%
Total Financial Assets	**13,526,197**	**13,057,202**	**12,595,185**	**3.6%**	**3.7%**	**96.2%**	**96.0%**
Equity Accounted Investments	667	705	744	-5.4%	-5.2%	0.0%	0.0%
Fixed Assets	73,443	73,826	85,528	-0.5%	-13.7%	0.5%	0.5%
Total Other Assets	461,197	473,389	460,568	-2.6%	2.8%	3.3%	3.5%
Total Assets	**14,061,504**	**13,605,122**	**13,142,025**	**3.4%**	**3.5%**	**100.0%**	**100.0%**

BALANCE SHEET - LIABILITIES (AED 000)	H1 23	2022Y	2021Y	Growth (%)		% of Total Assets	
Total Deposits from Banks	0	8	0	-100.0%	-	0.0%	0.0%
Total Deposits from Customers	8,275,856	7,861,976	7,700,120	5.3%	2.1%	58.9%	57.8%
Senior Debt	3,609	3,689	5,235	-2.2%	-29.5%	0.0%	0.0%
Derivative Liabilities	8	45	288	-82.2%	-84.4%	0.0%	0.0%
Total Financial Liabilities	**8,279,473**	**7,865,718**	**7,705,643**	**5.3%**	**2.1%**	**58.9%**	**57.8%**
Total Other Liabilities	415,881	412,384	385,647	0.8%	6.9%	3.0%	3.0%
Total Liabilities	**8,695,354**	**8,278,102**	**8,091,290**	**5.0%**	**2.3%**	**61.8%**	**60.8%**
Equity Attributable to Parent Company	5,366,150	5,327,020	5,050,735	0.7%	5.5%	38.2%	39.2%
Total Equity	**5,366,150**	**5,327,020**	**5,050,735**	**0.7%**	**5.5%**	**38.2%**	**39.2%**

INCOME STATEMENT (AED 000)	H1 23	2022Y	2021Y	Growth (%)		% of Avg Total Assets	
Interest Income	357,860	462,475	326,953	54.8%	41.4%	5.1%	3.5%
Interest Expense	67,352	64,010	49,801	110.4%	28.5%	1.0%	0.5%
Net Interest Income	**290,508**	**398,465**	**277,152**	**45.8%**	**43.8%**	**4.1%**	**3.0%**
Net Fee & Commission Income	**15,674**	**36,173**	**43,782**	**-13.3%**	**-17.4%**	**0.2%**	**0.3%**
Gains on Securities & Other Trading	-	39,164	34,104	-	14.8%	-	0.3%
Equity Accounted Results	-38	11	-197	-790.9%	-105.6%	0.0%	0.0%
Other Operating Income	-	61,198	37,838	-	61.7%	-	0.5%
Operating Income	**374,460**	**535,011**	**392,679**	**40.0%**	**36.2%**	**5.3%**	**4.0%**
Personnel Expense	-	92,421	79,905	-	15.7%	-	0.7%
Other Operating Expense	-	62,352	56,864	-	9.7%	-	0.5%
Operating Expense	**77,064**	**154,773**	**136,769**	**-0.4%**	**13.2%**	**1.1%**	**1.2%**
Operating Profit (Pre-Impairment)	**297,396**	**380,238**	**255,910**	**56.4%**	**48.6%**	**4.2%**	**2.8%**
Customer Loans Impairment Exp	41,336	18,065	-15,120	357.6%	-219.5%	0.6%	0.1%
Impairment on Financial Assets	**41,468**	**15,722**	**-8,258**	**427.5%**	**-290.4%**	**0.6%**	**0.1%**
Non-Financial Inv Impairment	805	0	0	-	-	0.0%	0.0%
Asset Writedowns	**42,273**	**15,722**	**-8,258**	**437.8%**	**-290.4%**	**0.6%**	**0.1%**
Pre-tax Profit	**255,123**	**364,516**	**264,168**	**40.0%**	**38.0%**	**3.6%**	**2.7%**
Net Profit	**255,123**	**364,516**	**264,168**	**40.0%**	**38.0%**	**3.6%**	**2.7%**
Net Profit Attributable to Parent	255,123	364,516	264,168	40.0%	38.0%	3.6%	2.7%

Ratios annualised where appropriate.
Abbreviated versions of Balance Sheet and Income Statement. Individual items may not sum to totals.
Total Other Assets excludes insurance and non-current assets.
Sources: CI Ratings, Bank financials, S&P Global Market Intelligence (SNL financial data).

SUPPLEMENTARY INFORMATION

I. Ratings History (Past Four Actions)

Bank's Issuer Ratings and Outlook

	Current	Sep 2022	Sep 2021	Sep 2020
LT Foreign Currency	A-	A-	A-	A-
ST Foreign Currency	A2	A2	A2	A2
Outlook Foreign Currency	Stable	Stable	Stable	Stable
Bank Standalone	bbb	bbb	bbb	bbb
Outlook Bank Standalone	Stable	Stable	Stable	Stable
Core Financial Strength	bbb	bbb	bbb-	bbb-

Memo:
Sovereign Ratings – United Arab Emirates

	Current
Long-Term Foreign Currency	AA-
Short-Term Foreign Currency	A1+
Outlook Foreign Currency	Stable
Long-Term Local Currency	AA-
Short-Term Local Currency	A1+
Outlook Local Currency	Stable

II. Regulatory Disclosures

About the Ratings

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This rating action follows a scheduled periodic (annual) review of the rated entity. Ratings on the entity were first released in August 1994. The ratings were last updated in September 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 assigned or maintained at the request of the rated entity or a related third party.

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