United
Arab Bank

Bank Rating Report

United Arab Bank

United Arab Emirates

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The ratings have been disclosed to the rated entity and were amended following that disclosure. Ratings on the issuer were first released in July 1994. The ratings were last updated in July 2017.

The principal methodology used in determining the ratings is the Bank Rating Methodology. The methodology, the meaning of each rating category, the time horizon of rating outlooks and the definition of default, as well as information on the attributes and limitations of CI's ratings, can be found at www.ciratings.com. Historical performance data, including default rates, are available from a central repository established by ESMA (CEREP) at http://cerep.esma.europa.eu.

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UNITED ARAB BANK

Sharjah, United Arab Emirates
July 2018

RATINGS

	Current	Last Changed From	Date
Sovereign			
Long-Term:	**AA-**	-	-
Short-Term:	**A1+**	-	-
Outlook:	**Stable**	-	-
Foreign Currency			
Long-Term:	**BBB**	BBB+	Jun 17
Short-Term:	**A2**	A3	May 08
Financial Strength	**BBB**	BBB+	Jun 17
Support	**3**	4	May 08
Outlook			
Foreign Currency	**Stable**	Negative	Jun 17
Financial Strength	**Stable**	Negative	Jun 17

FINANCIAL HIGHLIGHTS

USD (mn) AED (mn)	2017 USD	2017 AED	2016 AED	2015 AED
Total Assets	5,647	20,739	21,252	23,664
Net Loans	3,575	13,128	13,346	15,672
Customer Deposits	4,098	15,050	15,538	16,775
Total Capital	589	2,165	2,087	2,570
Gross Income	184	677	861	1,196
Net Profit	5	17	-522	-183
Exchange Rate: USD/AED		*3.67*	*3.67*	*3.67*

%	2017	2016	2015
NPL / Gross Loans	8.73	7.26	4.95
LLRs / NPLs	83.31	95.05	100.28
Capital Adequacy Ratio	13.20	13.10	14.60
Net Loans / Stable Funds	76.44	70.56	74.21
Net Interest Margin	2.33	2.82	4.00
Cost / Income	54.71	43.26	41.08
ROAA	0.08	-2.33	-0.74

RATINGS DRIVERS

Supporting the Rating

- A fully subscribed rights issue in March 2018 strengthened CAR to a sound level, but it remains lower than peer-group average.
- More than full coverage of impaired loans at end Q1 2018, although the non-performing loan (NPL) ratio is still high. Other asset quality indicators showed improvement in 2017 and are at acceptable levels.
- Good loan-based liquidity ratios overall which strengthened in Q1 2018. Customer deposits remain the principal source of funding. Growing investment portfolio is of strong quality. Good stock of liquid assets and other marketable securities.

Constraining the Rating

- Low profitability ratios; however, both operating profitability and ROAA improved in Q1 2018.
- In common with peers, customer concentrations in the deposit base and loans are high by global standards but on par with other banks of similar size; relatively small balance sheet.
- Residual asset quality problems in the corporate loan book arising from the challenging credit environment of the previous two years could continue to adversely impact the loan book; however business sentiments have improved with the recent rise in oil prices.

RATING RATIONALE

Capital Intelligence Ratings (CI Ratings or CI) has affirmed the Financial Strength Rating (FSR) of United Arab Bank (UAB) at 'BBB'. The improved capital ratios (following a rights issue of shares in Q1 2018) and more than full coverage of NPLs after the adoption of IFRS 9 along with overall good and improved (in Q1 2018) liquidity ratios are the major factors supporting the rating. The key constraining factors are ongoing weak operating profitability and ROAA, although the improvement in Q1 2018 in both ratios is noted, and customer concentrations in loans and deposits in common with peers. CI notes that there could still be residual problems in the corporate loan portfolio of local banks as a result of the weak economic growth of the previous two years. However, the recent strengthening of business sentiments is encouraging.

UAB's Long-Term Foreign Currency Rating (FCR), which is supported and constrained by the same factors as the FSR, is also affirmed at 'BBB'. The Short-Term FCR is maintained at 'A2' and reflects the Bank's overall good liquidity metrics. Despite the current strained relations between UAE and Qatar, UAB's largest shareholder, The Commercial Bank Q.S.C. (Cb), fully subscribed to its AED688mn rights issue in March 2018. UAB's Support Rating is maintained at '3', signifying a high likelihood of federal government assistance in case of need. The Outlook for all the ratings is 'Stable' in view of the Bank's improved capital ratios, the more than full coverage of NPLs and the small increase in profitability ratios in the first quarter of this year. However, the Bank's low profitability at present makes it more vulnerable to external shocks; a major deterioration in asset quality going forward could put downward pressure on the ratings.

UAB's business transformation process is now complete. The Bank believes that this can deliver sustainable returns while reducing overall risk. In the first phase (which began in late 2015 and accelerated in 2016) the focus was on unwinding legacy issues with the emphasis on reducing risk, bringing down the cost base, 'churning' the asset portfolio, and managing recoveries. Resolving NPLs and exiting from non-core, stressed assets was more time consuming than was originally believed and this has resulted in a disproportionate drag on income as it tied up capital.

In 2017, one major corporate default contributed to the increase in NPLs and the deterioration in the NPL ratio. However, all other asset quality indicators (related to past due not impaired loans, and watch-listed and restructured loans) improved last year. Now that the 'non-core' portfolio has shrunk to a very low 2% of gross loans, no major asset quality reversals are expected in the coming months. While not discounting the fact that the core portfolio could also produce some surprises, we believe that the core book is performing adequately and that the anticipated growth in lending would help to keep asset quality parameters in check going forward. The improvement in the loan-loss reserve (LLR) coverage ratio is expected to be maintained following the adoption of IFRS 9 on 1 January 2018.

The increase in paid-up equity in March 2018 has strengthened capital ratios to sound levels. Moreover capital is not impaired by unprovided NPLs. However, key capital-related metrics remain weaker than the peer group average. The Bank is now in a position to grow its businesses and increase its earnings, which are likely to be fully retained for a few years in line with the conservative dividend policies approved by the board. Given the risk-averse credit policies in place, asset growth is likely to be moderate and capital ratios at year-end are unlikely to be significantly lower than current levels.

While profitability ratios improved in Q1 2018, there are still challenges in this area. Reduced loan volumes, a higher proportion of corporate credit in the loan mix (in line with new strategies), and an increased level of low-yielding, but high quality, investments have reduced margins and operating profits. This was partly offset by lower operating costs on the back of staff layoffs, the closure of branches and the winding down of businesses that are not part of the new strategies. Operating profit continued to fall in 2017 as in the previous two years, but the decline in risk charges allowed the Bank to report a small net profit. The improvement in key ratios in Q1 2018 suggests that the Bank's new strategies, which led to a significant de-risking of the loan portfolio and the growth in investments, are delivering results in terms of the quality of earnings if not volume. CI expects further improvements in profitability in 2018 and beyond.

Liquidity levels are good. Customer deposits and capital continue to be the Bank's principal resources and short-term interbank liabilities remain low. The Bank has a moderate amount of medium-term obligations on its balance sheet which can be comfortably refinanced. Customer concentrations in the deposit base remain high. Liquid assets and non-government marketable securities together represent a high percentage of the balance sheet. Even allowing for a moderate expansion of lending this year, CI expects UAB to maintain its liquidity ratios within an acceptable range going forward.

PERFORMANCE OUTLOOK

Although the core portfolio did not grow in Q1 2018, given the increase in capital in the first quarter, CI expects all key businesses to expand in the remaining quarters. However, the overall growth rate is likely to remain moderately low. The Bank is focusing substantially on reducing its cost of funds which had been adversely impacted by the decline in demand balances resulting from the implementation of strategies de-leveraging its non-core customer accounts. The 12% increase in demand balances in Q1 2018 (over end 2017) is encouraging. CI also notes that CASA deposits rose to 29% of customer deposits at end Q1 2018 from 26% at end 2017; this bodes well for the funding cost. The capital increase in March 2018 would also have a favourable impact on the average funding cost for this year. Rising levels of corporate banking activity are expected to strengthen non-interest income this year. On-going efforts to optimise overhead costs could further reduce operating expenses – the Bank is aiming for a cost to income ratio of around 46%-47% in 2018 as against 55% in 2017. Risk charges are likely to stay around the Q1 2018 level in the remaining quarters of the year unless there are surprises. Overall, CI expects both operating profitability and ROAA to strengthen this year, but both ratios are still expected to remain moderately low. Barring any external shocks to the Bank's financials UAB could return to good profitability in 2019 or 2020.

Bank History

United Arab Bank (UAB) was incorporated in the emirate of Sharjah in 1975 by leading UAE businessmen and France's Societe Generale (SocGen). For strategic reasons, SocGen sold its 20% stake in early 2005.

Table 1: Major Shareholders (31 May 2018)	
The Commercial Bank Q.S.C.	40.00%
H E Sheikh Faisal bin Sultan Al Qassimi	10.27%
Al Majed Investment Company (WLL)	5.42%
Juma Al Majed Abdullah Muhairi	5.31%

In late 2007 The Commercial Bank Q.S.C. (Cb) acquired a 34.7% interest in UAB and entered into a strategic alliance with the Bank. Cb raised its holdings to 40% at end-March 2008. Cb, which is the second largest bank in Qatar, is a publicly-held company listed on the Doha Securities Market. It has four representatives on UAB's nine-member board but no management services contract with the Bank.

Cb is considerably larger than UAB and is a major bank in Qatar with a diversified business base and good access to international capital markets. Its capital position improved in 2017 after a rights issue of shares. However, it has relatively weak asset quality despite three years of heavy provisioning and substantial write-offs. Its coverage ratios remain modest and weaker than peers. As in the case of other Qatari banks liquidity ratios of Cb are tight. CI recently affirmed the FCR Long-term rating of Cb at A- and the Short-term at A2, while the FSR was maintained at 'BBB+' (See CI Ratings Report on The Commercial Bank Q.S.C. dated April 2018).

In September 2017, Cb gave Tabarak Investment LLC, an Abu Dhabi based private equity firm, a period of exclusivity to negotiate the terms of the potential sale of its 40% shareholding in UAB. Although there have been several extensions of the exclusivity agreement, the transaction has still not taken place. Media reports suggest that the private equity firm has been given more time to negotiate the terms (and possibly raise financing) and complete the transaction. That said, Cb subscribed to UAB's rights issue of shares in Q1 2018. The Bank's acting CEO was changed in March 2018.

Table 2: The Commercial Bank Q.S.C. Key Financials	2017	2016
Total Assets (USD billion)	38.0	35.8
Total Capital (USD billion)	5.8	5.3
Net Profit (USDmn)	166	138
ROAA	0.45	0.40
NPLs/Gross Loans (%)	5.65	5.24
LLRs/NPLs (%)	81.04	78.91
Capital Adequacy Ratio (%)	16.08	15.19

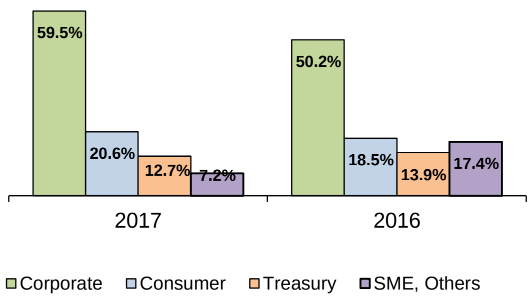
UAB's other shareholders with more than 5% of equity each are UAE businessmen (see Table 1). H.E. Sheikh Faisal Bin Sultan Al Qassimi, a member of the ruling family of Sharjah and an important founder shareholder, continues as chairman of UAB.

Current Business Model

Substantial changes in the business model have been effected since late 2015. The business model changed from the last quarter of 2015, following a substantial increase in bad loans from the SME segment.

Chart 1 shows the relative shares of the corporate, consumer, treasury and other (mainly SME) segments in the Bank's gross income in 2016 and 2017. The shares of both the corporate and retail divisions increased in 2017, while that of treasury and SME fell. However, the SME and retail segments reported net losses last year (Retail – AED67mn and SME and others – AED152mn) due to impairment provisions.

Chart 1: Gross Income of Major Businesses



The core portfolio is now a significant portion of total loans The Bank's core business from Q4 2015 onwards has been corporate and institutional banking, which primarily focuses on large and mid-corporate customers in both private and public sectors. The non-core portfolio comprising 1) the SME book and 2) retail loans for self-employment activities, was wound down in 2016 and 2017 via repayments and write-offs, and no new loans have been made to any of these segments since the last quarter of 2015. At end 2017, the core portfolio formed a high 98% of total loans.

The branch network has been rationalised Retail banking activities now serve primarily to complement the corporate and institutional banking divisions; new growth is to come from the sales of personal and mortgage loans and credit cards to the employees of the Bank's corporate and institutional customers. The downsizing of retail operations, particularly the closure of branches, the reduction in headcount and lower marketing and publicity expenses, has generated cost savings. The Bank had 14 domestic branches at end 2017, which the management regards as an optimal level.

UAB is now primarily a corporate banking institution offering a range of corporate and treasury services to mainly medium-sized and large companies in the UAE. These are chiefly well established companies with multiple sources of revenues and diversified businesses, which have experienced steady growth over several years. State-owned entities and financial institutions are also major customer segments being targeted. The Bank intends to offer customised services and build strong relationships with target client groups.

Principal Business Strategies

The first phase of UAB's transition to a new business model that focuses on unwinding the legacy portfolio is almost at an end. In the second phase, beginning from Q1 2018 following the injection of new capital, the Bank aims to expand business volumes. It is now focusing on re-building its business with special emphasis on the traditional corporate and institutional sectors, which is supported by trade finance, retail banking and treasury services. The new structure will see a deepening of customer relationships in the corporate sector, while treasury and retail banking growth will essentially be driven by cross sales of key products to the main corporate/institutional segment.

UAB aims to maintain its CAR at above 14% and to reduce its cost of risk (provision charge to gross loans) to less than 1% over the long-term. The Bank will not be paying dividends in the 2017-19 period as it completes its transformation. UAB intends to maintain medium-term borrowings at the end 2017 level and ensure that customer deposits remain the core source of funds. UAB expects to deliver a higher net profit in 2018 compared to the previous year through income growth and continuing cost reductions. The overriding focus is on improving profitability by transitioning to a lower risk business model.

RECENT ECONOMIC AND FINANCIAL SECTOR DEVELOPMENTS

See Appendix at the end of the report.

KEY FINANCIAL ISSUES

The 2017 consolidated accounts, comprising the financial statements of the Bank and its small, 100% owned subsidiary (for investments and advisory services), were audited by PWC in accordance with the International Standards on Auditing. The financial statements were prepared in accordance with International Financial Reporting Standards (IFRS) and the requirements under UAE law. The auditor's report is unqualified. The impact of adopting IFRS 9 led to a negative AED314mn adjustment to opening capital at the beginning of Q1 2018.

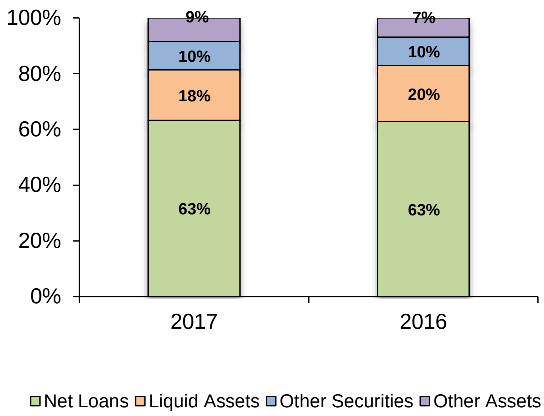
Peer group/sector averages in the following analysis are taken from CI Ratings' peer group table. These ratios are the size-weighted averages of 15 banks that accounted for 71% of the total assets in the banking system.

BALANCE SHEET

Asset Quality

Balance sheet totals declined for the third consecutive year. Total assets fell by 2.4% in 2017 to AED20.7 billion (USD5.6 billion). This is a small bank with a less than 1% share of the total banking assets in the country. Over the last few years the Bank has shrunk its balance sheet size as it has exited from several non-core activities and focused on corporate banking and related activities which it considers its core business.

Chart 2: Total Assets Breakdown



All major asset classes on the balance sheet continued to decline last year. However, the overall balance sheet structure did not change significantly (see Chart 2). Net loans represented 63% of total assets at end 2017 largely unchanged from the previous year-end. Liquid assets declined to 18% of the balance sheet total from 20%, while marketable securities (other than government securities) were stable at 10%. Fixed assets and other miscellaneous assets increased to 9% of total assets from 7% a year ago due to assets acquired in settlement of debt amounting to AED275mn, compared to AED20mn in the previous year.

Moderately sized investment portfolio is of high quality. The Bank has built up its liquid asset holdings to meet regulatory ratios. Net investments recorded a modest 3% increase in 2017 to AED3.4 billion. The portfolio represented 16.5% of the balance sheet total at end 2017, up from 15.6% a year ago. A substantial 94% of the book was in the available-for-sale (AFS) category, and level 1 category investments were also around 94% of investment holdings. Market prices are available for the whole book. Almost the entire portfolio consisted of debt securities at end 2017; issuances by sovereigns and government-related entities constituted a sizeable 78% of securities and 22% consisted of bank and public sector issuances. The investment book has no impairments. Investments rated in the 'A' category by external agencies formed 51% of total investments.

Table 3: Sectoral Loan Distribution at end 2017					
Sector	**AEDmn**	**% of Total**	**%Δ over 2016**	**NPL Ratio* 2017 (%)**	**NPL Ratio* 2016 (%)**
Retail Loans	3,322	23.5	-9.2	**3.76	**2.09
Trade	2,088	14.7	-13.1	13.75	10.68
Personal Loans - Business	2,525	17.8	27.0	**	**
Manufacturing	1,633	11.5	-10.4	17.70	3.65
Services	1,480	10.5	2.0	27.57	23.70
Financial Institutions	1,220	8.6	-0.4	-	-
Construction	798	5.6	3.4	0.13	3.06
Government/Public Sector	479	3.4	-20.3	-	-
Transport and Communications	590	4.2	49.0	0.17	0.50
Others	23	0.2	15.0	-	-
Gross Loans*	14,158	100.0	-1.2		
Non-Core Portfolio	287	2.03	-56.4	-	-

**as percentage of gross sector loans, NPLs exclude PDNI>90 days; **Retail and Personal Business loans aggregated under Retail loans*

Modest contraction in gross loans in 2017, following large declines over the previous two years; small increase in the core portfolio. Gross loans fell by a modest 1.2% in 2017 to AED14.2 billion, after shrinking by 13% in the previous year and by 11% in 2015. The non-core portfolio, comprising exposures to SMEs and unsecured personal loans, shrank 56% YoY and amounted to just AED287mn at end 2017. This is reflected in the decline in retail loans and exposures to the trade and manufacturing sectors, as shown in Table 3. Core loans, principally corporate loans to select industries and retail loans associated with these targeted companies, recorded a modest 1.4% increase to AED13.9 billion and formed a substantial 98% of gross loans. The Bank intends to continue to reduce its non-core book and use the funds so released to build its core business. Most of the growth in the core business was across the personal business loans, services, construction and transport sectors.

Retail loans comprised mainly personal loans against the assignment of salaries and end-of-service benefits. These are offered primarily to employees of government institutions and corporate customers on the Bank's approved list of companies. Impaired loans in the personal loan book (retail and business) amounted to 3.76% of gross loans in these two segments at end 2017, up from 2.09% a year ago. The Bank also regularly writes off past due retail loans.

Low real estate exposure. The Bank does not have exposures to real estate developers working on freehold or other properties in Dubai. However, UAB does have indirect exposures via loans secured by real estate and its small home mortgage portfolio.

High levels of customer concentrations, in line with the sector. Credit outstanding to the 20 largest borrowing customers amounted to 29% of gross loans at end 2017. The ten largest borrowing customers accounted for 22% of gross loans. The second largest exposure was to the government. Two of the top 20 customers had low internal ratings of 8 or more.

Long-term loans have increased over the last few years, to 41% of gross loans at end 2017 from 18% three years ago (see Table 4)**.** Short-term loans maturing in less than a year remained stable at 33%. CI expects the short-term component of the loan portfolio to rise as the Bank grows its corporate banking working capital finance, which is a major part of the Bank's core business.

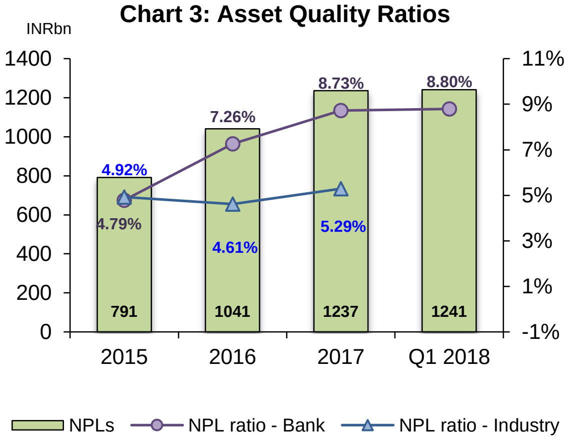
Table 4: Gross Loans by Maturity (%)

	<1year	1-5 years	>5 years	Total
2017	33	27	41	100
2016	33	35	32	100
2015	32	40	28	100
2014	38	44	18	100

Related-party exposure as a percentage of total capital is moderately high but in line with the ratios of peers. The ratio dropped to 30% at end 2017 from 33% a year ago reflecting reduced levels of both funded and non-funded exposures to related parties. Total exposures fell to AED645mn from AED681mn in the previous year. This is about average in the UAE for a bank with no government shareholders. The high ratio at end 2016 is also attributed to the fall in the capital that year following a net loss. Liabilities from related parties, comprising customer deposits and medium-term borrowings, also declined last year to AED290mn from AED466mn at end 2016.

Note: CI Ratings' definition of NPLs includes all loans over 90 days past due. UAB has identified certain loans as past due not impaired (PDNI) even though these are more than 90 days overdue. This is either because recovery is imminent or the loans are adequately collateralised or being restructured.

Chart 3: Asset Quality Ratios



Q1 2018 NPLs exclude PDNI>90 days

NPL growth in 2017 was due to a default by one manufacturing entity; most of the legacy problem accounts have been dealt with. NPLs, rose by 19% in 2017 to AED1.2 billion and with the modest contraction in gross loans, the NPL ratio rose to 8.73% at end 2017 from 7.26% a year ago. This is well above the peer group average, which also increased last year (see Chart 3). However, the increase in NPLs in 2017 was mainly due to an AED175mn exposure to one of the largest manufacturers of PET resin in the country and the GCC region, which collapsed last year. The exposure is partly collateralised, and media reports indicate that the company's parent in India is working with lenders to resolve the problem. NPLs (excluding PDNI>90 days) rose by 3% in Q1 2018 over end 2017; the NPL ratio (excluding PDNI>90 days) was at 8.80%.

The Bank wrote off fewer loans in 2017 (AED273mn) compared to the previous year (AED860mn). Consequently, the NPL net accretion rate slowed to 45% from 133% a year ago. The average for the sector in 2017 was 92%.

Other asset quality indicators show improvement (see Table 5). Loans that may be under some stress but are not considered impaired declined in 2017 both in absolute terms and as a percentage of gross loans. PDNI>90 days loans dropped to AED30mn (0.21% of gross loans) at end 2017 from AED215mn (1.50%) a year ago. Additionally, loans less than 90 days past due also declined and were very low. There was a reduction in watch listed (still performing) loans. Re-negotiated loans also declined last year (see Table 5).

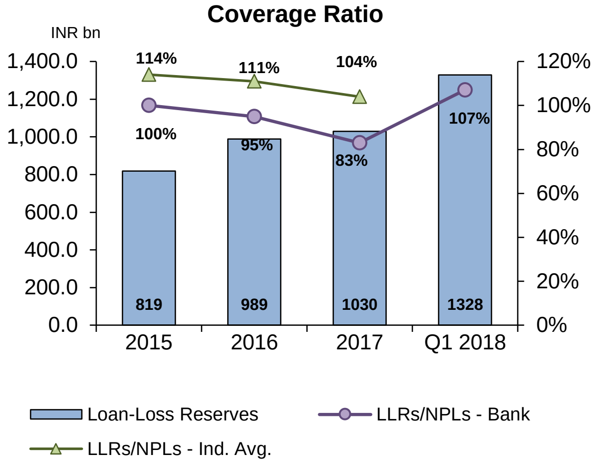
Table 5: Asset Quality Indicators

As % of Gross Loans	2017	2016
PDNI>90 days	0.21	1.50
<90 days PDNI	0.62	0.93
Watch listed	8.47	11.87
Re-negotiated Loans	7.40	9.90

The services, trade, sector, manufacturing and retail sectors account for the bulk of NPLs. The growth in NPLs in 2017 was largely due to one account in the manufacturing sector and partly to impairments in the trade, services and retail sectors. UAB had stopped extending fresh credit to the SME and other sectors, which it considered non-core in 2015 and these additional impairments in the trade, services and retail sectors represent residual problems in the portfolio. There were also reductions in impaired loans in the construction, transport and communications and other sectors.

The slow growth of the domestic economy had created stresses in the SME segment. A prolonged period of low oil prices and the slow economic activity over the last few years, along with lower levels of liquidity impacted small businesses in the country resulting in higher impaired loans not just at UAB but across the banking sector. Several expatriate business owners in the commodities trading and small contracting sectors fled the country leaving sizeable unpaid debt. The country's inadequate bankruptcy laws at that time, which put issuers of bounced cheques behind bars, had contributed to the problem of fleeing expatriates. These laws have been amended and going forward loans to SMEs may pose less of a risk than they have in the past.

Chart 4: Loan Loss Reserves and Coverage Ratio



LLR coverage ratio declined in 2017, but recovered in Q1 2018. The LLR coverage ratio fell to 83% at end 2017 from 95% at the end of the previous year. This was well below the peer group average of 104% (see Chart 4). Management states that including the value of collateral against NPLs the coverage ratio was 130% at end 2017. Total LLRs rose by AED297mn in Q1 2018, of which AED249mn was related to the IFRS 9 led adjustment to capital. The LLR coverage ratio strengthened to 107% at end Q1 2018.

Despite the growth in NPLs the Bank's net charge for loan losses was much lower in 2017 than in the previous year. UAB's loan loss provisioning expense to gross loans ratio dropped to 2.04% from 7.06% in 2016. This is partly because of collateral available on the impaired portfolio.

The Bank states that 65% of the value of corporate exposures at end 2017 was secured by collateral, up from 51% at end 2016. It has successfully repossessed real estate collateral in the past.

Table 6: Coverage Ratios

	2017	Q1 2018 Post rights
Unprovided NPLs/ Free Capital	13.11	0.00
Effective NPL Coverage	2.11	2.64
Unprovided NPLs/ Operating Profit	8.08	0.00
Provision expenses/Gross Loans	2.04	*1.53

**annualised*

Capital buffer strengthened following the rights issue in Q1 2018. The decline in the coverage ratio in 2017 might not have been of concern if the capital buffer had not fallen at the same time.

Following the rights issue in Q1 2018, the Bank's capital cover for impaired loans has risen. Free capital exceeded NPLs at end Q1 2018 and the effective NPL coverage ratios showed an improvement (see Table 6).

Capital Adequacy

Table7: Capital Parameters			
	Q1 2018	2017	Regulatory
CET 1	14.00	12.00	7.00
CAR	15.70	13.20	10.50
CCB**	-	-	1.25
Capital/TA*	12.40	10.44	-

** total assets; ** capital conservation buffer*

Capital adequacy ratio (CAR) was below the peer group average at end 2017; but post rights issue key ratios have strengthened. The Bank's Basel III CAR was 13.20% at end 2017, up from the Basel II CAR of 13.10% at end 2016. This was due to a small 3.4% increase in regulatory capital which more than offset the 2.6% rise in risk-weighted assets last year.

The bulk of UAB's capital consists of paid-up equity and reserves and consequently its CET 1 ratio was close to its CAR. However the Bank's CAR was below the peer group average of 19.21% at end 2017. Following the AED688mn rights issue the CAR increased to a more sound 15.70% at end Q1 2018 partly aided by a small decline in risk-weighted assets. The enhanced capital base provides a moderate level of buffer against future asset quality shocks and capital is also not impaired by unprovided NPLs. The new capital also absorbed the AED314mn reduction in equity in Q1 2018 because of the adoption of IFRS 9. However, the Bank's key capital ratios continue to lag behind those of its peers.

Moderately high capital to total assets ratio, which remains below the peer group average. The Bank raised AED688mn from its shareholders including Cb in Q1 2018. This represented a 17% increase in the Bank's capital, which rose to 12.4% of the balance sheet total, from 10.4% at end 2017. This is still lower than the peer group average (2017: 14.41%). Most of the other banks of similar size have much higher capital to total assets ratios. No cash or stock dividends have been paid over the last three years; before that the Bank had gradually reduced its cash dividends in an effort to plough back its earnings into capital. Shareholders were given bonus shares over this period instead of cash dividends.

UAB's capital rose by 3.7% in 2017 due to an 11% rise in reserves which in turn was due to the small net profit of AED17mn, which was fully retained, and other comprehensive income of AED61mn representing net changes in fair value of AFS investments.

Liquidity

Customer deposits fund a large portion of the balance sheet. Customer deposits funded 73% of the balance sheet at end 2017, unchanged from the previous year-end, and capital contributed 10%. This is supplemented by a small amount of medium-term borrowings and due from banks with remaining contractual maturities of over one year (3% of total assets,) and short-term interbank liabilities, including AED844mn of medium-term funds that fall due in 2018 (9%). The Bank had raised medium-term funding in the past to reduce its asset/liability maturity gaps and to widen its sources of funds. Refinancing risks are not significant at present given the small size of borrowings. The Bank can refinance or rely partly on internal cash flows to repay these obligations as they mature.

Customer deposits have declined over the last few years in line with contraction of the loan book; high level of time deposits contributes to the Bank's high funding cost. Although customer deposits have shrunk over the last three years the rate of decline dropped to 3% in 2017 from 7% in 2016 and 10% in 2015. The decline over the last three years was more or less in line with the contraction of the loan book.

The YoY drop in customer deposits was primarily because of reduced demand balances, which fell by 11% in 2017 and formed 24% of total customer deposits at year-end, as against 26% at end 2016. This primarily reflects the reduction in corporate banking activity and withdrawals by exiting SMEs and other non-core corporate customers. Time deposits were largely unchanged at AED11.1 billion at end 2017 but constituted a higher portion of the customer deposit base (74%) compared to the previous year (71%). The fall in CASA balances in 2017 is likely to have contributed to the rise in the Bank's funding cost although rising interest rates have done most of the damage.

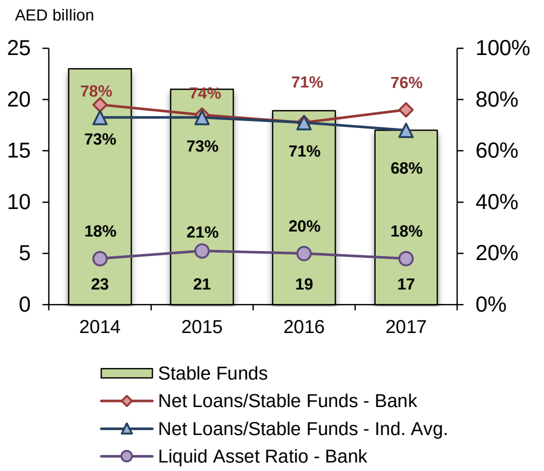
Customer deposits are largely short-term funds. In common with most of the sector, the bulk (98%) of UAB's customer deposits had maturities of less than a year. All banks in the UAE have wide asset/liability maturity gaps in the short end of the maturity spectrum due to the high level of short-term deposits on their balance sheets.

Customer concentrations are high. The 20 largest depositors accounted for 44% of customer deposits at end 2017, up from 36% a year ago.

Liquidity ratios tightened in 2017 but remained satisfactory. Since customer deposits shrank at a faster pace then net loans, key loan-based liquidity ratios tightened last year. The net loans to customer deposits ratio rose slightly to a still good 87% at end 2017 from 86% a year ago, but was better than the peer group average of 90%. Stable funds, comprising customer deposits, medium-term funds and capital, declined by a sizeable 9% in 2017. This was partly because of the contraction in the deposit base and partly because medium-term funds fell by 71% (CI's definition of stable funds excludes all medium-term borrowings maturing in less than a year). The net loans to stable funds ratio consequently rose sharply to a still comfortable 76% at end 2017 from 71% a year ago. This was much tighter than the peer group average (see Chart 5).

Liquid asset holdings declined in 2017 but were still at an acceptable level, particularly in view of the high level of good quality marketable securities. UAB's liquid asset ratio fell to 18% at end 2017 from 20% a year earlier owing to reduced central bank balances. Liquid assets consist mainly of cash and balances with the central bank (54% at end 2017) and government securities (35%), but also includes a small amount of deposits with banks (11%). In addition, the Bank has investments in other non-government marketable securities (10% of total assets at end 2017), which can be disposed of, or repo'd through a Central Bank window, to create liquidity. Liquid and quasi-liquid assets together formed a high 28% of total assets at year-end, although this was down from 30% at end 2016. The net liquid asset ratio (after reducing short-term interbank liabilities) fell to 9% due to a high level of medium-term funds maturing next year, which are likely to be refinanced.

Chart 5: Liquidity



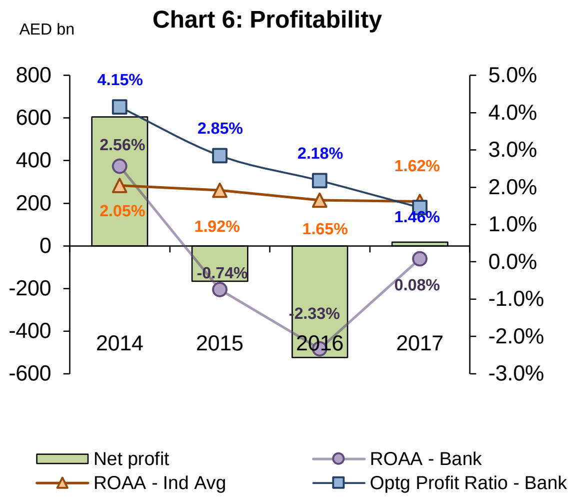
In addition, the Bank has access to the central bank's liquidity support facility that will allow it to borrow up to 120% of its cash reserves.

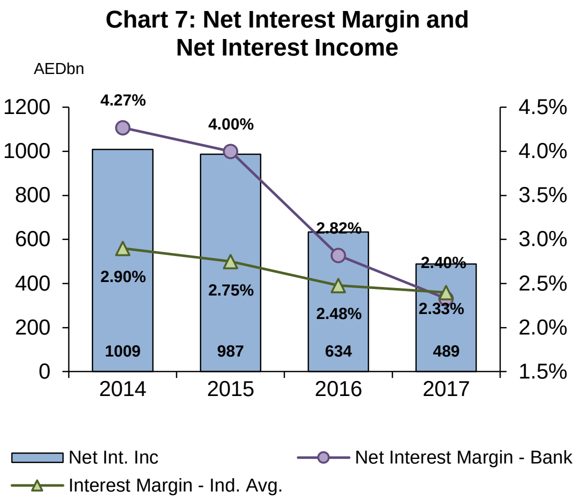
Maturity gaps widened in the less-than-three-month bucket. UAB's negative gap in the less-than-three-months maturity bucket represented a high 34% of total assets reflecting its sizeable short-term deposits. The Bank expects a large portion of its time deposits being rolled over on maturity. Although reduced corporate banking activities led to the contraction of demand balances, historically, these balances have tended to be sticky and have constituted stable funding for many years. In addition, a high percentage of customer deposits with tenors of less than three months is rolled over on maturity.

Table 8: Assets *Less* Liabilities as a percentage of total assets

%	2017	2016
0-3 months	-34	-30
3-12 months	-16	-10
1-5 years	21	17
Over 5 years	30	23

FINANCIAL PERFORMANCE





Operating profitability has fallen steadily and is now low due to credit contraction, but CI believes that the planned growth in balance sheet assets going forward would address this. UAB's operating profit declined for the third consecutive year in 2017. There was a sizeable 37% fall in operating profit to AED307mn in 2017 (31% in 2016 and 28% in 2015). As a result, the operating profit to average total assets (ATA) ratio has fallen steadily and was a low 1.46% last year (below the peer group average of 2.34%). However, that ratio rebounded to 1.75% (annualized) in Q1 2018.

The change in the loan mix in favour of low-risk corporates contributed to the decline in average yields on credit. The fall in operating profits between 2015 and 2017 is largely attributed to the Bank's shrinking net interest income, which fell by 23% in 2017 to AED489mn (2016: -36%). Interest income declined by 11% last year, which in turn was due to lower interest earned on loans and advances. This primarily reflects changes in the Bank's strategies focusing on low-risk corporate accounts and the reduction in exposures to high-yielding, but higher-risk, SME and small business customers. Despite the increase in interest rates in 2017, the Bank's interest income to ATA ratio fell by 19bps to 4.01% but CI notes that this is not too different from the comparable ratios of other small corporate banks in the country.

Rising funding costs have also negatively impacted the net interest margin, which has fallen and is now lower than the peer-group average. Despite a fall in customer deposits last year, the Bank's interest expenses rose by 14% owing to the rise in interest rates and a change in the deposit mix in favour of the more expensive time deposits. The funding cost rose by a substantial 30bps to 1.68% at which point it became the third highest in CI's peer group table. UAB's funding cost has historically been higher than the peer group average but the difference between the two has widened in recent years. UAB's demand balances are likely to rise as a percentage of customer funds as the Bank builds its corporate banking activities and introduces cash management and transaction banking products. Management states that the difference between its cost of funds and the Emirates Interbank Offer Rate has narrowed in recent periods and this has partly helped to offset reducing yields.

Table 9: Break up of Fees and Commissions		
AEDmn	**2017**	**2016**
Letters of Credit	21.5	20.6
Guarantees	33.2	25.2
Loans	67.8	58.1
Expenses	-16.5	-20.0
Total Fees and Commissions	106.0	83.9

Non-interest income (NII) has remained low, but the growth in fee and commission income in 2017, following declines in previous years, is a positive development. NII fell by 18% in 2017 to AED188mn. This was due mainly to a 42% decline in foreign exchange profits to AED40mn and a 44% fall in miscellaneous income largely on account of reduced realised gains from the sale of AFS investments. However, CI notes that the Bank's fee and commission income rose by 26% in 2017 to AED106mn, with key areas like guarantees and loan fees recording solid gains (see Table 9). The NII to ATA ratio was a low 0.89% in 2017, which was well below the peer group average of 1.30%.

Small decline in operating costs, but cost to income ratio has worsened due to reduced gross income. Following a sizeable 24% decline in operating costs in 2016 due to staff retrenchments, the consolidation of branches and the rationalisation of businesses, the Bank's cost base recorded only a marginal fall in 2017. Staff costs continued to decline in 2017 (by 4% to AED215mn), as did occupancy and maintenance costs (by 9%), legal fees (by 22%) and equipment write-offs (by 57%). However, other administrative expenses rose by 127% to AED43mn due to a one-off loss of AED31mn recognized on a fraud case. Excluding this one-off cost operating expenses dropped by 12% in 2017. With gross income falling by 21% last year, the cost to income ratio worsened to 55% in 2017 from 43% a year ago.

Substantial fall in the net risk charge led to a small net profit in 2017. The net impairment charge fell to AED289mn from AED1 billion a year ago partly reflecting a reduced amount of loan write offs and a lower NPL accretion rate. The net charge to ATA ratio was well below the 2016 figure of 4.50%, although it remained high at 1.38%. The Bank's ratio was on a par with the 2017 sector average. Impairment charges are expected to taper off as the Bank builds its high-quality business and its non-core loan portfolio declines. UAB reported a small net profit of AED17mn in 2017 as against a net loss of AED523mn in 2016. The ROAA was however very low at 0.08%.

CURRENT YEAR UPDATE (Q1 2018)

The table below highlights UAB's unaudited financials for the first quarter of 2018.

AEDmn	**Mar 18**	**Dec 17**	**Δ%**
Total Assets	20,441	20,739	-1.4
NPLs(excl PDNI>90 days)	1,241	1,206	2.9
LLRs	1,328	1,030	28.9
Net Loans	12,781	13,128	-2.6
Investments	3,724	3,413	9.1
Customer Deposits	14,969	15,050	-0.5
Total Capital	2,536	2,165	17.2

%	**Mar 18**	**Dec 17**
NPLs(excl PDNI>90 days)/Gross Loans	8.80	8.52
LLRs/NPLs(excl PDNI>90 days)	107.01	85.39
Capital Adequacy Ratio	15.70	13.20
Net Loans/Stable Funds	73.01	76.44
Quasi-Liquid Asset Ratio	30.03	28.18

%	**Q1 18**	**Q1 17**
Net Interest Margin*	2.49	2.24
Non-Interest Income/ATA*	0.89	0.97
Cost to Income	48.10	50.70
Operating Profit/ATA*	1.75	1.58
ROAA*	0.70	0.52

AEDmn	**Q1 18**	**Q1 17**	**Δ%**
Net Interest Income	129	119	7.6
Non-Interest Income	46	51	-11.4
Gross Income	**174**	**171**	**1.9**
Operating Expenses	84	87	-3.4
Operating Profit	**90**	**84**	**7.3**
Provisions	-54	-56	-3.5
Tax	-	-	-
Net Profit	**36**	**28**	**29.2**

**annualized; ATA – average total assets.*

Balance sheet.

Slow growth in NPLs and improved LLR coverage ratio; rights share issue has strengthened capital ratios; liquidity metrics have strengthened and are good.

- The balance sheet total fell by 1.4% over Q1 2018 reflecting a small decline in net loans and reduced central bank balances and other assets, which were partly offset by the growth in investments and due from banks. The fall in net loans was partly due to the IFRS 9 adjustment leading to an increase in provisions and partly because of the continued reduction of the non-core portfolio; the core book was stable. The NPL ratio recorded a small increase over end 2017 to 8.80% but the significantly slower growth in NPLs over the quarter compared to the full year 2017 is noted. The LLR coverage ratio strengthened to 107% at end Q1 2018 following the addition of AED284mn to LLRs after the adoption of IFRS 9 and the expected credit loss model.

- An AED688mn equity infusion substantially offset a net comprehensive loss (AED1.7mn) due to negative fair value changes in investments. Capital increased by a strong 17% over end 2017 and the CAR strengthened to a sound 15.7% from 13.2% at end 2017. Because of the capital increase the effective NPL coverage ratio also improved – to a still low 2.6 times from 2.1 times at end 2017.

- Customer deposits fell marginally, while due to banks dropped by a fifth. The Bank's medium-term liabilities of AED845mn mature in 2018 and may be refinanced. The growth in capital and the reduction in net loans led to a good improvement in the net loans to stable funds ratio to 73% from 76% at end 2017. Due to increased investments in 'high quality liquid assets' the quasi-liquid asset ratio also increased – to 30%.

Profit and Loss.

Key profitability ratios strengthened YoY owing to higher net interest income and lower operating costs and risk provisions.

- Net interest income rose by a good 7.6% YoY due to the repricing of loans in the core portfolio, although in terms of average volumes loans were stable. Good fund management limited the increase in interest costs resulting in a 25bp increase in the NIM to 2.49% (annualised). Non-interest income dropped by 11% owing to reduced levels of fee and commission income and foreign exchange profits which were partly offset by higher levels of other miscellaneous income.

- Operating costs continued to fall, by 3.4% YoY, in line with strategies to rationalise the branch network and reduce staffing levels. The cost to income ratio improved to a still high 48%, as against 51% in Q1 2017. The costs to ATA ratio was unchanged at 1.63% (annualised).

- The risk charge continued to fall albeit at a relatively low pace of 3.5%. However, the net charge to ATA ratio remained on the high side at 1.05% (annualised) and the net charge to operating profit ratio was also high at 60%. Since the non-core book is currently at a low 2% of gross loans there could be a further moderation in the risk charge in the coming quarters.

- The Bank reported a 29% rise in net profit to AED36mn, while the ROAA rose to (a still low) 0.70% from 0.52% in the corresponding period of the previous year (both ratios annualised).

APPENDIX

RECENT ECONOMIC AND FINANCIAL SECTOR DEVELOPMENTS

GDP growth rate continued to slow in 2017. UAE's real GDP growth rate is projected to have slowed to 1.3% in 2017 from 3% in 2016; this is still one of the best performing countries in the GCC. The economy continues to be fairly resilient, compared to neighbouring markets, due to the country's diversified business base, the general ease of doing business and government initiatives which have stressed on diversification and the growth of non-oil sectors. Moreover, financial buffers have allowed fiscal consolidation to proceed more gradually. Although the oil sector GDP contracted last year owing to lower oil prices and OPEC supply cuts, the non-oil sector rose by 3.3% reflecting higher public investment, recovering global trade and improved domestic business sentiments underpinned by the increase in oil prices last year. The real estate residential market continued on its gradual slide in terms of property prices and rental yields due to an oversupply of units and softer job markets. Although the sector may see some stability in 2018 with the housing market having bottomed, out at least in Dubai, it continues to face headwinds because of rising fiscal restraints, higher interest rates and a stronger exchange rate.

Real output is expected to grow by an average of 2% in 2018-19. Economic activity is likely to strengthen gradually with firming oil prices and reduced fiscal consolidation. The growth rate of the non-oil GDP is expected to stay above 3% as public investment continues to rise in the run up to Expo 2020 and due to recovering global trade. However the outlook remains subject to ongoing risks arising from geopolitical uncertainties. Inflation averaged around 2.1% in 2017, reflecting soft domestic demand and declining rents – usually a sign in the UAE of weakening economic conditions. The introduction of VAT in January 2018 is not expected to significantly impact inflation parameters this year.

High sovereign ratings affirmed in January 2018. CI affirmed the UAE's Foreign Currency Long-term Rating at AA-, the Short-term at A1+ and the Outlook for the ratings at 'Stable'. The ratings reflect the strength of the country's external position, characterised by the availability of substantial financial assets to mitigate declining revenues stemming from the reliance on hydrocarbons. The ratings are also supported by additional factors including the stable domestic political situation, the diversified base of the current account receipts, including tourism revenues, which mitigates the dependence on oil exports, and high GDP per capita. A further additional factor is the strong support of the oil rich emirate of Abu Dhabi for the federation. The principal constraining factors are the vulnerability to oil prices shocks due to the country's relative dependence on hydrocarbon revenues, and the escalating geopolitical risk in view of the ongoing tension with Qatar, continued conflict in Iraq and Syria and the involvement in the war in Yemen. Other factors are the relatively high contingent liabilities from government-related entities (GREs), especially in Dubai and the weak – albeit improving – institutional framework and limited data transparency.

Fiscal finances continue to be vulnerable to oil price volatility. Based on CI forecasts of an average of USD55.0 per barrel and incorporating limited fiscal consolidation measures in the upcoming two years, the consolidated budget deficit is expected to narrow further to an average of around 1.6% of GDP in 2018-19. The consolidated budget deficit is expected to go back to surplus after 2020, premised on international hydrocarbon prices picking up and exceeding the fiscal breakeven price of USD 67.1 per barrel. Around 89% of the Abu Dhabi government's revenues is derived from royalties and taxes on ADNOC and foreign companies involved in oil and gas production. With relatively small and declining oil reserves, the Dubai government relies more on non-hydrocarbon revenues, such as customs duties and enterprise profits, which account for around 78% of total revenue.

At present, the government's refinancing risks whether on a federal or emirate level remain limited. Nonetheless, continued increases in US interest rates and/or higher geopolitical risk factors could trigger higher costs of refinancing. In this context, Dubai GREs are likely to face higher refinancing costs in view of the relatively large maturities in 2017-18, totalling USD35.9 billion or 34.5% of Dubai's GDP. CI notes that the consolidated government debt stock remained moderate at 20.7% of GDP in 2017 and is broadly matched by government deposits in the banking system; it is also dwarfed by public external financial assets. There is limited disclosure on the latter but it is estimated that the Abu Dhabi Investment Authority, the largest of the UAE's several wealth funds, has around USD770 billion under management. This is three times as large as the country's total external debt (as estimated by the IMF). While the consolidated net creditor position cannot be taken as an indicator of the solvency risk of individual emirates, CI would expect that Abu Dhabi, being the wealthiest emirate, would provide financial assistance to the federal government and/or the central bank if required.

Abu Dhabi's fiscal breakeven price for oil is low compared to many other countries. This could help to stretch the period during which fiscal consolidation will be undertaken. Dubai particularly has benefited from the flight of wealth and people from Arab countries affected by popular uprisings. Abu Dhabi's solid economic fundamentals and the very low levels of social tensions across all seven emirates make for social and political stability in the UAE.

Dubai's total government and GRE debt remains high in nominal value, at an estimated USD170 billion according to the latest IMF report but the GREs debt servicing capacity remains limited. Dubai GRE debt continued to be considerable at around 112% of Dubai GDP in 2016 and large maturities in the region of 35% of GDP are due in 2017-2018. In Abu Dhabi, GREs have substantially reduced their debt (to USD56.4 billion or 24.7% of Abu Dhabi's GDP in 2016) and they pose limited contingent liability to the consolidated government debt profile.

Dubai's trade sector remains resilient. Dubai's reputation as a trading hub, its location as a convenient transit point for Africa, Asia and Europe and its excellent infrastructure continues to sustain its preeminent position as a major entrepot in the region. Dubai's non-oil foreign trade rose to AED1.3 trillion in 2017, up AED26 billion from 2016. China, India, the US and Saudi Arabia are major trading partners. The sector's overall resilience is underpinned by a very diversified foreign trade business, business friendly policies and substantial infrastructure investments by local authorities. Financing trade flows remains an important activity for the banking sector.

Banking sector outlook has improved. The total assets of the banking sector recorded a growth of 4% in 2017. Gross loans rose by a modest 1.7% to AED1.6 trillion at end 2017 – the growth was led by lending to the private sector – mainly businesses. The deposit base of the banking sector rose by 4% to AED1.6 trillion with the government and public sector entities accounting for a sizeable 76% of the YoY increase. The sector remained very strongly capitalised with a CAR of 18.9% and a high Tier 1 component of 17.4% at end December 2017. Better oil prices, some easing of fiscal consolidation, rising global trade and increased investments ahead of Dubai's Expo 2020 have improved prospects for 2018.

Challenges faced by the banking sector in 2018. The introduction of 5% VAT could impact bank profits this year; although interest income is exempt, non-interest income is not. With dollar interest rates likely to rise, deposit costs are expected to be higher and it may cost more to refinance maturing wholesale borrowings. The growth in lending will largely be determined by the Abu Dhabi government's expenditure budget. The UAE federal government boosted spending on the back of stronger economic activity and higher oil prices and approved a record budget for 2018 with the focus on education, healthcare and community well being. The Dubai government approved its biggest every budget for 2018 which will ramp up spending on infrastructure ahead of the Expo 2020. The construction and real estate sector would continue to provide opportunities for growth for local banks, along with the trading and tourism sectors which are doing well.

Asset quality is expected to stay stable overall and banks expect NPLs to decline by end 2018 due to fewer accretions and good recoveries. However, delayed payments by government entities in both Abu Dhabi and Dubai are becoming a concern, especially for small businesses and this could affect past due loans in the banking sector. Unsecured retail loans may continue to be impacted by job losses, which are likely to continue this year. Most of the banks have trimmed their operating costs over the last couple of years and nearly all are investing in the digital space. The adoption of IFRS 9 has negatively impacted the banking sector's regulatory capital but the sector is expected to remain strongly capitalised throughout the year. Liquidity remains good in the banking sector thanks to some inflows from the government sector. The disappearance of Qatari banks from the interbank market have helped to stabilise the cost of interbank borrowings.

Banking sector reforms. The central bank instituted asset quality reviews of all banks last year as a result of which some of the smaller banks saw a sizeable increase in provisioning expenses. Major changes are afoot at the central bank which is setting up a regulatory framework which could see changes in the way local financial institutions are run. A series of standards is being developed to cover a wide range of functions including corporate governance. A new banking law is being enacted which is expected to give more power to the central bank. However, these are likely to be ready only by 2020. Basel III standards became effective from end 2017. The regulatory minimum CET 1 ratio is 7%, the Tier 1 ratio is 8.5% and total CAR is 11.75%, including a capital conservation buffer of 1.25%, which will increase to 2.5% by 2019. Some liquidity requirements (liquidity coverage ratio and liquid asset ratio) were imposed from 2016 on the larger banks. The net stable funding ratio will become effective from 1 January 2018 for the larger banks; this ensures that long term assets on the banks' balance sheet are funded using a sufficient amount of stable liabilities and it also requires some stable funding to cover a portion of the contingent liabilities. As at end April 2018 there were only four domestically systemically important banks in the country – First Abu Dhabi Bank, Emirates NBD, Dubai Islamic Bank and Abu Dhabi Commercial Bank.