

## CREDIT OPINION

4 May 2017

Update

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### RATINGS

#### United Arab Bank PJSC

Domicile	United Arab Emirates
Long Term Deposit	Baa2
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

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

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## United Arab Bank PJSC

### Update Following Recent Outlook Change to Negative

#### Summary Rating Rationale

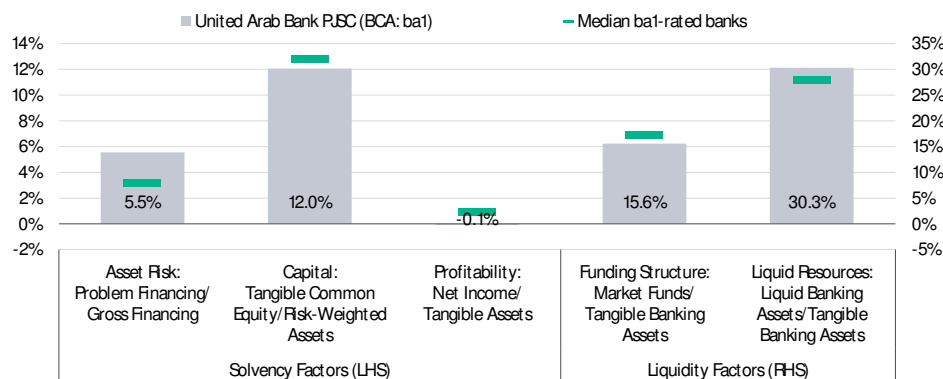
On 27 April 2017, Moody's has affirmed United Arab Bank's Baa2 long-term deposit ratings, its Prime-2 short-term deposit ratings, ba1 adjusted baseline credit assessment (BCA), ba1 BCA and Baa1(cr)/Prime-2(cr) Counterparty Risk Assessment. At the same time, Moody's has changed the outlook on the bank's long-term deposit ratings to negative from stable.

While United Arab Bank has over the last eighteen months made progress in winding down its high risk assets, the change in outlook to negative, from stable reflects (1) the downside risk of further asset quality deterioration, stemming from both its high-risk exposure to non-core small businesses and its concentrated exposure to core mid corporates, (2) the potential for pressure on profitability resulting from high provisioning requirements, and (3) potential pressure on capitalisation.

Moody's affirmation of the bank's Baa2 long-term deposit ratings, despite the bank incurring a loss and high provisioning charges in 2016, reflects the bank's still sound capitalisation, funding and liquidity, moderated by weak asset quality and profitability. The affirmation also reflects the continued assessment of a 'high' likelihood of government support if needed.

In October 2015, the bank commenced a strategic transformation intended to lower its risk profile by re-focusing its activities on corporate and institutional banking, while running down its non-core portfolio which led to net losses in 2015 and 2016. United Arab Bank is an affiliate of The Commercial Bank (P.S.Q.C.) (CBQK; A2 stable, baa3).

Exhibit 1  
Rating Scorecard - Key Financial Ratios



Note: The problem loan and profitability ratios is the weaker of the average 3-year ratios and the latest reported ratios. The capital ratio is the latest reported figure. The funding structure and liquid asset ratios are the latest year-end figures.  
Source: Moody's Investors Service

## Credit Strengths

- » Sound capital buffers
- » Deposit base supports the funding and liquidity profile
- » Our assessment of a 'high' likelihood of government support from the United Arab Emirates authorities in case of need

## Credit Challenges

- » High-risk exposure to non-core small businesses and concentrated exposure to core mid corporates will continue to pose risk to asset quality
- » Legacy exposures and transformation execution challenges will continue to weigh on profitability

## Rating Outlook

The negative outlook on the bank's long-term ratings reflects (1) the downside risk of further asset quality deterioration; (2) the potential for pressure on profitability resulting from high provisioning requirements and (3) potential pressure on capitalisation.

## Factors that Could Lead to an Upgrade

Upward pressure on the ratings of United Arab Bank is limited given the negative outlook on its rating. A significant reduction in the risk profile, combined with an increase in capital buffers and a substantial and sustainable improvement in core profitability could lead to a stabilisation of the ratings.

## Factors that Could Lead to a Downgrade

Downward pressure on the bank's ratings could materialise from a further deterioration of asset quality metrics and/or capitalisation buffers and/or a material weakening in the bank's funding and liquidity profile.

## Key Indicators

Exhibit 2

### United Arab Bank PJSC (Consolidated Financials) [1]

	3-17 <sup>2</sup>	12-16 <sup>2</sup>	12-15 <sup>2</sup>	12-14 <sup>2</sup>	12-13 <sup>2</sup>	Avg.
Total Assets (AED million)	21,273	21,252	23,664	25,709	21,550	-0.3 <sup>3</sup>
Total Assets (USD million)	5,792	5,786	6,443	7,000	5,867	-0.3 <sup>3</sup>
Tangible Common Equity (AED million)	2,152	2,124	2,647	2,978	2,530	-4.0 <sup>3</sup>
Tangible Common Equity (USD million)	586	578	721	811	689	-4.0 <sup>3</sup>
Problem Loans / Gross Loans (%)	5.5	7.0	4.6	2.8	1.6	4.3 <sup>4</sup>
Tangible Common Equity / Risk Weighted Assets (%)	12.0	12.2	13.9	13.9	15.2	13.5 <sup>5</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	25.8	32.4	22.1	14.8	9.2	20.8 <sup>4</sup>
Net Interest Margin (%)	2.3	2.9	4.0	4.4	4.5	3.6 <sup>4</sup>
PPI / Average RWA (%)	1.9	-	3.5	-	5.0	3.5 <sup>5</sup>
Net Income / Tangible Assets (%)	0.5	-2.5	-0.8	2.4	2.6	0.4 <sup>4</sup>
Cost / Income Ratio (%)	50.7	43.3	41.1	28.7	30.6	38.9 <sup>4</sup>
Market Funds / Tangible Banking Assets (%)	14.9	15.6	17.2	11.4	13.1	14.4 <sup>4</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	29.5	30.3	27.5	24.2	22.1	26.7 <sup>4</sup>
Gross Loans / Due to Customers (%)	91.3	92.0	98.1	98.5	103.4	96.7 <sup>4</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Compound Annual Growth Rate (%). Any interim period amounts presented are assumed to be fiscal year end amounts for calculation purposes [4] Simple average of periods presented [5] Simple average of Basel II periods presented

Source: Moody's Financial Metrics

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Detailed Rating Considerations

### UAE's STRONG- MACRO PROFILE SUPPORTS UNITED ARAB BANK'S RATINGS

The bank's standalone profile takes into account its operations in the UAE (Strong-), where 91% of its total assets were located as of December 2016. United Arab Bank benefits from the country's very high economic strength, which stems from high levels of economic wealth and the country's sizable hydrocarbon reserves. Additionally, the UAE's sound policy framework and strong growth in the non-oil hydrocarbon sector continues to drive economic diversification that supports the operating environment, particularly in the current low oil price environment.

Our view of UAE's operating environment also incorporates (1) the effects of continued oil price declines which is subduing economic confidence and moderating the country's growth prospects; (2) public spending plans, particularly in Abu Dhabi that continue to drive both public and private-sector economic growth and partially cushion the impact of low oil prices; and (3) the resilience of Dubai's diversified non-oil private sector.

The substantive sovereign wealth fund buffers and relatively low debt levels allow for the continuation of spending over the outlook horizon, although the prolonged fall in oil prices has already resulted in prudent budget rationalization, such as the recent withdrawal of fuel subsidies, discussions on regional VAT and corporate tax policies and likely deferral of non-core projects. The country remains moderately susceptible to event risk, owing primarily to geopolitical tensions in the region and Dubai's open economy coupled with its overall leverage appetite. The rating of the UAE government is Aa2 with a negative outlook.

### HIGH-RISK EXPOSURE TO NON CORE SMALL BUSINESSES AND CONCENTRATED EXPOSURE TO CORE MID CORPORATES WILL CONTINUE TO POSE RISK TO THE ASSET QUALITY

We expect United Arab Bank's asset risk to remain elevated owing to its exposure to high-risk non-core small businesses and to concentrated core mid corporates. Given the large amount of credit that was available over recent years, the softer economic activity in the country will continue to pressure the creditworthiness of the small business segment, against which the bank had materially increased its exposure since 2011.

While the bank has over the last eighteen months made material progress in winding down its high risk assets, we believe that the bank's problem loan ratio does not fully reflect its asset risk given the elevated level of provisioning, restructuring and write-off of delinquent exposures. However, we expect the gradual wind down of the high-risk assets to reduce progressively the problem loans formation over the medium term.

While we expect the bank to reduce further its stock of non-core legacy assets, there remains a risk, given the soft economy and the bank's concentrated core loan book, of core exposures currently classified as performing migrating to non-performing loans. The bank has reduced its non-core loans to 4% of net loans as of end-March 2017, from 11.2% as of year-end 2015.

As of March 2017, United Arab Bank's problem loans to gross loans ratio increased to 5.6% (4.6% as of year-end 2015), which compares unfavourably with the 4.6% local average and the 3.2% ba1 global median. Net charge offs accounted for 0.4% of gross loans as of end-March 2017 (5.9% during 2016) from 3.6% in 2015. The bank's loans loss reserves to problem loans ratio stood at 117% at end-March 2017 (95% at year-end 2016, 104% at year-end 2015), higher than the 95% ba1 global median.

Exhibit 3

#### Exposure to Non-Core Operations Has Reduced but Related Problem Loans Remain High Breakdown of Assets (left hand side chart) and of Net impairment losses (right hand side chart) as of end-2016



Source: United Arab Bank's Financial Statements

### SOUND CAPITAL BUFFERS

We expect United Arab Bank to continue to maintain sound risk weighted capitalisation metrics despite last two loss-making years and limited expected profit generation, given the anticipated muted RWA growth as the bank undergoes transformation. The sound capital buffers constitute a protection for creditors during the implementation of the strategic transformation plan.

As of March 2017, the bank reported a Tangible Common Equity to RWAs ratio of 12.0% down from 13.9% as of end-2015, which is lower than the 14.6% UAE system average and the 12.8% ba1 global median. The bank's Basel II Tier 1 ratio of 12.1% and shareholders' equity to total assets ratio of 10.2% remained sound. The bank's capital adequacy ratio of 13.2% at end March 2017 remained above the local minimum regulatory threshold.

### LEGACY EXPOSURES AND TRANSFORMATION EXECUTION CHALLENGES WILL CONTINUE TO WEIGH ON PROFITABILITY

While the bank has returned to profit during the first quarter of 2017, we expect its profitability to remain relatively low into 2017, stemming from continued restructuring and provisioning charges from the non-core unit, combined with moderate growth in the bank's target core business.

The achievement of the strategic transformation plan would be positive for bondholders over the long term, as it would stabilize earnings at a lower and more sustainable base, while reducing the level and volatility of provisioning charges. However, the significance of the execution challenges related to the transformation still offsets the benefits to creditors. The speed and cost of running off the non-core assets while originating lower risk business will be an important driver of the bank wide profitability.

United Arab Bank's profitability has been under pressure over the last two years stemming from provisioning and restructuring charges from its legacy non-core unit. Indeed, provisions generated by non-core assets remain elevated despite the substantial runoff in RWA achieved so far, with provisioning charges consuming a high 207% of the pre-provision income during 2016, compared to 126% in 2015. In the first quarter of 2017, this dropped to 67%. The bank's cost-to-income ratio at end-March 2017 increased to 51% from 43% during 2016 (41% in 2015).

The bank's net interest margins, which declined to 2.3% at end-March 2017 from 4.0% during 2015, have partially moderated the high cost of risk. This decline reflects the reduced exposure to the high yielding non-core unit as well as the funding cost increase in a tighter funding environment (to 1.9% during Q1 2017, from 1.1% during 2015).

### DEPOSIT BASE SUPPORTS THE FUNDING AND LIQUIDITY PROFILE

We expect the funding and liquidity profile of United Arab Bank to remain stable, as the bank's muted credit growth limits the pressure from the tighter funding environment.

As of March 2017, the bank's market funds to tangible banking assets ratio decreased to 14.9% (15.6% as of YE 2016, 17.2% as of YE 2015), which is lower than the 19.3% UAE average and the 17.2% ba1 global median. United Arab Bank's net loans to customers' deposits improved to 85% as of end-March 2017, from 93% as of YE 2015 (91% UAE system average) following the loan book contraction of the last two years.

As of March 2017, the bank's liquid banking assets to tangible banking assets stood at 29.5% (27.5% as of YE 2015), which is close to the 32% UAE system average and ba1 global median.

## Notching Considerations

### OUR ASSESSMENT OF A 'HIGH' LIKELIHOOD OF SUPPORT FROM THE UAE AUTHORITIES IN CASE OF NEED

UAB's Baa2 deposit rating incorporates a high likelihood of public support from UAE authorities in case of need that translates into a two-notch uplift from its ba1 BCA, based on UAE's strong record of supporting banks in time of stress.

### RATIONALE FOR ASSIGNING COUNTERPARTY RISK ASSESSMENT

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default; and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

The CR Assessment is positioned at Baa1(cr).

The CR Assessment, prior to government support, is positioned one notch above the Adjusted BCA of ba1 and therefore above deposit ratings, reflecting our view that its probability of default is lower than that of deposits. We believe senior obligations represented by the CR Assessment will be more likely preserved in order to limit contagion, minimize losses and avoid disruption of critical functions.

The CR Assessment also benefits from two notches of systemic support, in line with our support assumptions on deposits. This reflects our view that any support provided by governmental authorities to a bank which benefits senior unsecured debt or deposits is very likely to benefit operating activities and obligations reflected by the CR Assessment as well, consistent with our belief that governments are likely to maintain such operations as a going-concern in order to reduce contagion and preserve a bank's critical functions.

### Source of facts and figures cited in this report

The system averages quoted in the report are updated as of end-December 2016, unless otherwise stated and based on available audited system metrics. The global medians quoted in the report are updated as of March 2017 and are based on most recent full-year data. Unless noted otherwise, data related to system wide trends is sourced from the Central Bank of the UAE. Bank-specific figures originate from the bank's reports and Moody's Banking Financial Metrics. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the documents: "Financial Statement Adjustments in the Analysis of Financial Institutions" published on 12 February 2016.

### About Moody's Bank Scorecard

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

## Rating Methodology and Scorecard Factors

Exhibit 4

### United Arab Bank PJSC

#### Macro Factors

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

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	5.5%	ba1	← →	b1	Unseasoned risk	Quality of assets
Capital						
TCE / RWA	12.0%	baa3	← →	baa3	Expected trend	
Profitability						
Net Income / Tangible Assets	-0.1%	caa2	← →	b3	Expected trend	Loan loss charge coverage
Combined Solvency Score		ba2		ba3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	15.6%	baa2	← →	baa3	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	30.3%	a3	↓	baa2	Expected trend	
Combined Liquidity Score		baa1		baa3		
Financial Profile				ba2		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aa2		
Scorecard Calculated BCA range				ba1-ba3		
Assigned BCA				ba1		
Affiliate Support notching				0		
Adjusted BCA				ba1		

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	1	0	baa3 (cr)	2	Baa1 (cr)	--
Deposits	0	0	ba1	2	Baa2	Baa2

Source: Moody's Financial Metrics

## Ratings

Exhibit 5

Category	Moody's Rating
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### UNITED ARAB BANK PJSC

Outlook	Negative
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	Baa1(cr)/P-2(cr)

Source: Moody's Investors Service

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