CREDIT OPINION
16 August 2018

Update

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RATINGS

United Arab Bank PJSC

Domicile	United Arab Emirates
Long Term CRR	Baa2
Type	LT Counterparty Risk Rating - Fgn Curr
Long Term Deposit	Baa3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

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

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United Arab Bank PJSC

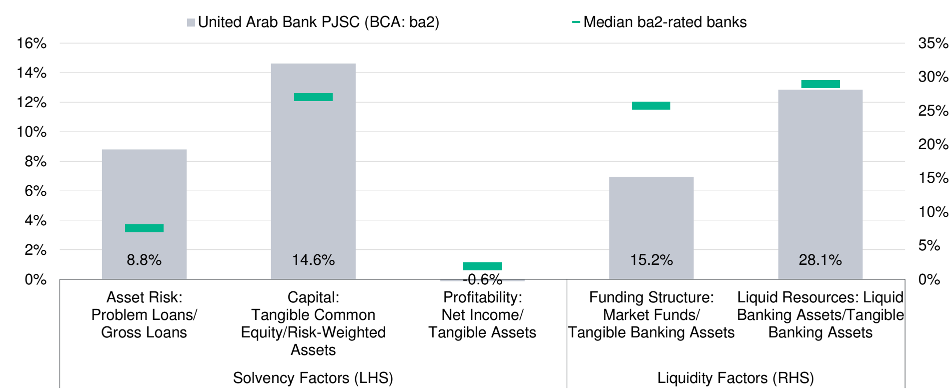
Update following recent downgrade to Baa3, outlook change to stable

Summary

United Arab Bank PJSC's (UAB) Baa3/Prime-3 deposit ratings incorporate a two-notch uplift from the bank's Baseline Credit Assessment (BCA) of ba2, based on our view of a high probability of support from the Government of the United Arab Emirates (UAE; Aa2 stable) in case of need. This assessment reflects UAE authorities' track record of supporting all local banks.

UAB's ba2 BCA reflects the bank's solid capitalisation, combined with sound funding and liquidity. However, the bank's weakening asset quality and low profitability moderated these strengths.

Exhibit 1
Rating Scorecard - Key financial ratios



The problem loan and profitability ratios are the weaker of the average three-year ratios and the latest reported ratios or the latest reported ratio. The capital ratio is the latest reported figure. The funding structure and liquid asset ratios are the latest year-end figures.
The problem loans/gross loans ratio included in the exhibit is the reported metric as of June 2018, not adjusted for Moody's usual adjustments for this ratio. This reflects the unavailability of the some figures (interest in suspense, as well as loans past due for more than 90 days but not impaired) in the quartery financial statements.
Source: Moody's Investors Service

Credit strengths

» Solid capital buffers

» Sound funding and liquidity, supported by the bank's deposit-based funding

» Our assessment of a high likelihood of government support in case of need

Credit challenges

» Asset quality will gradually stabilise at weak levels, concentrated exposure to medium-sized corporates poses tail risk amid soft environment

» Low lending growth amid soft environment will drive low profitability

Outlook

The stable outlook reflects our expectation that the bank's solid capitalisation, combined with its sound funding and liquidity, will balance its weakening asset quality and low profitability.

Factors that could lead to an upgrade

Upward pressure on the ratings could materialise through a significant improvement in asset quality, combined with sustainably higher profitability.

Factors that could lead to a downgrade

Downward pressure on the ratings could materialise through a deterioration in asset quality, and/or a weakening of capitalisation buffers.

Key indicators

Exhibit 2

United Arab Bank PJSC (Consolidated Financials) [1]

	6-18[2]	12-17[3]	12-16[3]	12-15[3]	12-14[3]	CAGR/Avg.[4]
Total Assets (AED million)	20,180	20,739	21,252	23,664	25,709	-6.7[5]
Total Assets (USD million)	5,494	5,647	5,786	6,443	7,000	-6.7[5]
Tangible Common Equity (AED million)	2,578	2,142	2,124	2,647	2,978	-4.0[5]
Tangible Common Equity (USD million)	702	583	578	721	811	-4.0[5]
Problem Loans / Gross Loans (%)	8.8	8.1	7.0	4.6	2.8	6.3[6]
Tangible Common Equity / Risk Weighted Assets (%)	14.6	12.0	12.2	13.9	13.9	14.6[7]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	32.0	37.2	32.4	22.1	14.8	27.7[6]
Net Interest Margin (%)	2.5	2.4	2.9	4.0	4.4	3.2[6]
PPI / Average RWA (%)	2.0	1.7	-	3.5	-	2.0[7]
Net Income / Tangible Assets (%)	0.8	0.1	-2.5	-0.8	2.4	0.0[6]
Cost / Income Ratio (%)	49.3	54.7	43.3	41.1	28.7	43.4[6]
Market Funds / Tangible Banking Assets (%)	16.6	15.2	15.6	17.2	11.4	15.2[6]
Liquid Banking Assets / Tangible Banking Assets (%)	28.1	28.1	30.3	27.5	24.2	27.6[6]
Gross Loans / Due to Customers (%)	101.2	93.5	92.0	98.1	98.5	96.6[6]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] May include rounding differences due to scale of reported amounts [5] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [6] Simple average of periods presented for the latest accounting regime. [7] Simple average of Basel III periods presented

Source: Moody's Financial Metrics

Profile

United Arab Bank (UAB), incorporated in 1975, offers a range of traditional and Shari'a-compliant corporate and retail banking services to UAE clients. The bank completed a transformation, initiated in the second half of 2015 and concluded at end-2017, which targeted a wind-down of its exposure to the high-risk small and medium-sized enterprises (SMEs), and an improvement in its operational efficiency.

With total assets of AED20.2 billion ($5.5 billion), the bank held a market share of 0.8% of banking assets in the UAE as of end-June 2018. UAB is an affiliate of the Commercial Bank (P.S.Q.C.) (CBQK; A3 stable, ba1), which has a 40% ownership stake in the bank as of 1 August 2018. For details on the UAE's banking system profile, please see United Arab Emirates: Banking System Profile.

Detailed credit considerations

Asset quality will stabilise at weak levels, concentrated exposure to medium-sized corporates poses tail risk amid soft environment

We expect UAB's asset quality to gradually stabilise at weak levels, as the soft economy in the UAE continues to strain the creditworthiness of small businesses and medium-sized companies (to which the bank materially increased its exposure between 2011 and 2014). The bank's low credit growth will also continue to have a denominator effect on the asset quality metrics. In addition, the bank's concentrated exposure to medium-sized corporates, as well as the elevated level of restructured exposures, pose tail risk amid a soft environment.

UAB has gradually wound down its legacy high-risk exposures between 2015 and 2017. The bank reduced its non-core loans to 1.9% of gross loans as of June 2018, from 10.7% as of year-end 2015. The clean-up exercise, combined with limited new lending, led to a 15% decline in the bank's gross loans between December 2015 and June 2018.

Following the clean-up exercise, UAB's problem loan formation has gradually slowed. The bank's cost of risk (loan loss provisions/gross loans) declined to 2.1% in 2017 (1.3% in H1 2018) from 7.1% in 2016. At end of June 2018, UAB's reported problem loans/gross loans ratio (NPL ratio) increased to 8.8% from 8.5% as of year-end 2017 (5.8% in December 2016). The bank's adjusted NPL ratio (adjusted for suspended interest, as well as loans past due for more than 90 days but not impaired) stood at 8.1% in December 2017 (7.0% in December 2016), comparing unfavourably with the 5.4% local average. The reported loan-loss reserves-to-problem loans ratio stood at 103.9% as of end-June 2018.

Solid capital buffers

We expect UAB to maintain its solid capitalisation, as its expected modest risk-weighted asset growth in 2018 balances the limited internal capital generation. The bank's AED687.5 million ($187 million) capital issuance completed in March 2018 helped the bank replenish its capital buffers (through an increase of around 400 basis points) and absorb the impact from the adoption of the IFRS9 accounting standards (around 176 basis points).

As of June 2018, the bank reported tangible common equity-to-risk-weighted assets ratio of 14.6% (in line with 14.7% UAE system average), compared with 12.0% as of year-end 2017. The bank's Basel III Tier 1 ratio of 14.4%, capital adequacy ratio of 15.5% and shareholders' equity-to-total assets ratio of 12.6% were solid.

Low lending growth amid soft environment will drive low profitability

We expect UAB's profitability to remain low in 2018, owing to low credit growth, increasing funding cost and relatively high and stabilising provisioning charges. The profitability will moderately improve over the medium term, as net lending growth gradually picks up and provisioning charges stabilise. The pace and the nature of the future credit growth will be an important driver of the profitability, after growth in high risk areas between 2011 and 2014 drove elevated delinquencies, followed by muted growth between 2015 and 2017 that constrained the profitability and internal capital generation.

Lending growth will remain muted into 2018, as the bank focuses on originating lower-risk business in a soft, challenging and competitive environment. The decline in economic and credit growth in the country amid lower oil prices, combined with elevated delinquencies in the small and medium-sized segments, has further increased competition for lower-risk exposures in the local over-banked system.

In addition, higher funding cost in the country owing to higher US rates will continue to weigh on the bank's interest margins. However, UAB managed to improve its net interest margins to 2.5% in the first half of 2018 from 2.4% during the full year 2017, as loan re-pricing helped offset the higher funding cost (2.3% during H1 2018, from 1.9% in 2017 and 1.6% in 2016).

Lower restructuring and provisioning charges will contribute to a moderate improvement in comparison to recent years. UAB's profitability has been under pressure over recent years, owing to elevated provisioning and restructuring charges. However, provisions have decreased gradually, consuming 53% of pre-provision income in first half of 2018, compared to 94% during the full year 2017 and 207% during the full year 2016. The bank's cost-to-income ratio stood at 49% in the first half of 2018 (55% during the full year 2017).

Sound funding and liquidity, supported by the bank's deposit-based funding

We expect UAB's funding and liquidity to remain sound as the bank's expected modest credit growth limits its funding requirements. However, the bank has a concentrated funding base which exposes it to volatility.

As of end-June 2018, the bank's market funds-to-tangible banking assets ratio decreased to 16.6% (15.2% as of year-end 2017), lower than the 17.6% UAE system average. UAB's net loans/customer deposits stood at 92% as of June 2018 (89% UAE system average). As of end-June 2018, the bank's liquid banking assets-to-tangible banking assets ratio stood at 28.1% same as year-end 2017, lower than the 33% UAE system average.

Support and structural considerations

Our assessment of a high likelihood of support from the UAE authorities in case of need

UAB's Baa3 deposit rating incorporates a high likelihood of public support from the UAE authorities in case of need, which translates into a two-notch uplift from its ba2 BCA, based on the UAE's strong record of supporting banks in times of stress. UAB does not have any government ownership. The Commercial Bank (P.S.Q.C.) (A3 stable, ba1) has a 40% stake in UAB.

Counterparty Risk Ratings (CRRs)

Counterparty Risk Ratings are opinions of the ability of entities to honour the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements.

We believe that CRR liabilities have a lower probability of default than the bank's deposit and senior unsecured debt as they will more likely be preserved to minimise banking system contagion, minimise losses and avoid disruption of critical functions. For this reason, we assign the CRRs, prior to government support, one notch above the Adjusted BCA.

UAB's CRRs are positioned at Baa2/P-2.

We consider UAE a jurisdiction with a nonoperational resolution regime. For nonoperational resolution regime countries, the starting point for the CRR is one notch above the bank's Adjusted BCA (ba2). In the case of UAB, and in line with our support assumptions on deposits, the CRR benefits from a two-notch uplift of systemic support. The bank's CRR is, therefore, one notch above the deposit ratings at Baa2.

Source of facts and figures cited in this report

The system averages quoted in the report are updated as of end-December 2017, unless otherwise stated and are sourced from the Central Bank of the UAE data and individual banks' financial statements. The global medians quoted in the report are updated based on most recent available data on Moody's-rated banks. 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 following document: Financial Statement Adjustments in the Analysis of Financial Institutions, published in August 2018.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity. Please refer to the document Banks, published on 1 August 2018.

Rating methodology and scorecard factors

Exhibit 3

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	8.8%	ba3	←→	b3	Unseasoned risk	Quality of assets
Capital						
TCE / RWA	14.6%	a3	←→	baa2	Expected trend	
Profitability						
Net Income / Tangible Assets	-0.6%	caa2	↓↓	b2	Expected trend	Loan loss charge coverage
Combined Solvency Score		ba2		ba3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	15.2%	baa2	←→	baa3	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	28.1%	baa2	←→	baa2	Stock of liquid assets	
Combined Liquidity Score		baa2		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				ba2		
Affiliate Support notching				0		
Adjusted BCA				ba2		

Instrument class	**Loss Given Failure notching**	**Additional Notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency Rating**	**Foreign Currency Rating**
Counterparty Risk Rating	1	0	ba1	2	Baa2	Baa2
Counterparty Risk Assessment	1	0	ba1 (cr)	2	Baa2 (cr)	--
Deposits	0	0	ba2	2	Baa3	Baa3

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	**Moody's Rating**
UNITED ARAB BANK PJSC	
Outlook	Stable
Counterparty Risk Rating	Baa2/P-2
Bank Deposits	Baa3/P-3
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Counterparty Risk Assessment	Baa2(cr)/P-2(cr)

Source: Moody's Investors Service

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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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