FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Al Masraf at 'A'; Outlook Stable

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Fitch Ratings - London - 03 Jun 2020: Fitch Ratings has affirmed UAE-based Arab Bank for Investment & Foreign Trade's (Al Masraf) Long-Term Issuer Default Rating (IDR) at 'A' with Stable Outlook and Viability Rating at 'b+'. A full list of rating actions is below.

KEY RATING DRIVERS

IDRS, SUPPORT RATING (SR), SUPPORT RATING FLOOR (SRF)

Al Masraf's Long- and Short-Term IDRs, SR and SRF reflect an extremely high probability of support available to the bank from the UAE and Abu Dhabi authorities, if needed.

Fitch's view of support factors in the sovereign's strong ability to support the banking system, sustained by sovereign wealth funds and recurring revenue, mostly from hydrocarbon production, despite lower oil prices. Fitch also expects a high willingness of the UAE authorities to support the banking sector, which has been demonstrated by their long track record of supporting domestic banks, and is also suggested by close ties with and partial government ownership of some banks.

Al Masraf's SRF is notched down from the Abu Dhabi banks' SRF for domestic systemically important banks (D-SIBs) of 'A+'. We believe support from the Emirate of Abu Dhabi would be available to the bank, if needed, given its incorporation in Abu Dhabi and the track record of the Abu Dhabi authorities providing capital support to all banks located in the emirate, including Al Masraf. Al Masraf's SRF is one notch below the D-SIB SRF due to the bank's moderate systemic importance. Abu Dhabi banks' D-SIB SRF is one notch higher than for other UAE banks due to Abu Dhabi's superior financial flexibility.

Al Masraf's Short-Term 'F1' IDR is the lower of two options mapping to a 'A' Long-Term IDR, as described in our rating criteria. This is because a significant proportion of UAE banking sector funding is related to the government, and a stress on Al Masraf is likely to come at a time when the sovereign itself is experiencing some form of stress. Fitch judges this "wrong-way" risk as high in the UAE, and this is reflected in the Short-Term IDR, which primarily reflects Al Masraf's liquidity and funding profile.

VR

Al Masraf's VR predominantly reflects the bank's small franchise and undiversified business model and weak asset quality, due to still substantial problem loans and high loan book concentrations. The VR also factors in Fitch's assessment of the bank's only adequate capitalisation, despite high capital ratios relative to peers, due to high potential problem loans, high concentrations and the small size of Al Masraf's capital base in absolute terms. The VR also considers adequate profitability, concentrated, albeit stable, funding and reasonable liquidity.

Al Masraf has a nominal franchise in the highly competitive UAE banking sector, accounting for less than 1% of system assets. The federal government of the UAE owns 42% of the bank's shares through the Emirates Investment Authority, the only UAE federal sovereign wealth fund. However, Al Masraf's franchise and business model do not benefit materially from this ownership. The bank's loan book exposures are primarily in Abu Dhabi and Dubai, with the bank serving long-standing customers, largely corporate entities owned by high-net-worth individuals. An undiversified business model involves considerable exposure to the real estate and construction sectors and a low contribution of non-interest revenues to operating income.

Al Masraf's weak asset quality and high concentration risk constrain the bank's VR. The impaired loans ratio (end-2019: 5.8%) is moderately above the UAE sector average of 4.7%, but remains contained and reserve coverage of impaired loans is sound (end-2019: 111%). However, total potential problem loans (Stage 2 + Stage 3 loans) were a high 26% of gross loans at end-2019. Stage 2 loans contracted in 2019, mostly due to migration back into Stage 1, but still represented a high 20% of the total book at end-2019 (end-2018: 28%).

Al Masraf's exposure to the real estate and construction sectors is about 29% of gross loans, which is at the higher end for the UAE sector. Fitch views both sectors as sensitive and sees them as a threat to the bank's asset quality due to decreasing real estate prices across the UAE, a trend we expect will be accentuated by the COVID-19 outbreak.

Concentrations in the bank's loan book by single name are also pronounced, although this is a common characteristic for the banking sector, and concentration is higher at some domestic peers. Al Masraf also has additional off-balance-sheet risks, mostly in the form of export letters of credit and guarantees, which were equivalent to a high 54% of total assets at end-2019.

Al Masraf's core capital ratios are well above peers, with a Common Equity Tier 1 ratio of 20.6% at end-2019 (peer average: 14%). However, Fitch views Al Masraf's capital buffers as only adequate due to significant event risk, the small size of the bank's capital base, substantial problem loans and concentrations on both sides of the balance sheet.

Al Masraf's non-equity funding consists predominantly of customer deposits (86% of non-equity funding at end-2019) and interbank funding. The bank has a high reliance on wholesale funding, particularly deposits from large corporate and government-related entities, which results in high deposit concentrations. However, these deposits have proved to be fairly sticky, in particular large term deposits from the UAE government. Despite Al Masraf's small franchise, 16% of customer deposits came from the retail segment at end-2019, which brings some diversification to the bank's funding profile.

Al Masraf also has significant and growing current accounts and savings accounts (CASA; 30% of customer deposits at end-2019), which benefit the bank's cost of funding. The loans/customer deposits ratio (106% at end-2019) is stable but still high relative to domestic peers and the stock of liquid assets is small at 9% of total assets at end-2019, covering only 13% of customer deposits.

Al Masraf's profitability metrics are adequate, benefiting from wider margins than peers, good cost control and low loan impairment charges. Its net interest margin tightened (NIM) fell to 3.5% in 2019 from 3.9% in 2018, due to lower rates in 2H19, but remains above the UAE peer average (2019: 3.0%), underpinned by a high portion of low-cost CASA deposits. Fitch anticipates that the bank's NIM will tighten in 2020, similarly to the sector, due to lower rates implemented in 1Q20.

The bank's management keeps a tight rein on costs and its cost-to-income ratio (33% in 2019) sits below peers. Nevertheless, the bank's operating profit/risk-weighted assets ratio (2.3% in 2019) is just in line with the sector average as the bank's small franchise and undiversified business model constrain fee income generation. Non-interest income improved, accounting for 21% of operating income in 2019 compared to 18% in 2018, but is well below the peer average of 31%. Fitch expects fee income generation to be impacted by subdued economic activity amidst the COVID-19 outbreak in 2020, while increased credit risk for the sector will see expected credit losses rise, leading to pressures on the bank's bottom line profitability, albeit in line with the sector.

RATING SENSITIVITIES

IDRS, SR, SRF

Al Masraf's IDRs, SR and SRF are sensitive to a change in Fitch's view of the creditworthiness of the UAE and Abu Dhabi authorities or of their propensity to support the banking system or the bank.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Given our already existing view of the high creditworthiness of the UAE and Abu Dhabi authorities and high propensity to support the banking system and the bank, positive rating action is unlikely. Although an increase in the bank's market share and systemic importance could be positive, this is unlikely in the medium term given the bank's prudent growth strategy.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Deterioration in our view of the creditworthiness of the UAE and Abu Dhabi authorities or their propensity to support the banking system or the bank could lead to a downgrade of the bank's IDRs.

VR

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of Al Masraf's VR would most likely come from an improvement in the bank's asset quality and in particular, a reduction in its problem loans and sector concentrations. It could also come from the bank growing its franchise and diversifying its business model.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Al Masraf's VR could be downgraded if the bank's problem and stage 2 loans increase further, affecting capitalisation and profitability.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Al Masraf's SRF is notched down from the Abu Dhabi banks' SRF for D-SIBs of 'A+'. We believe support from the emirate of Abu Dhabi would be available to the bank, if needed, given its incorporation in Abu Dhabi and the track record of the Abu Dhabi authorities providing capital support to all banks located in the emirate, including Al Masraf. Al Masraf's SRF is one notch below the D-SIB SRF due to the bank's moderate systemic importance. Abu Dhabi banks' D-SIB SRF is one notch higher than for other UAE banks due to Abu Dhabi's superior financial flexibility.

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The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Arab Bank for Investment and Foreign Trade PJSC	LT IDR	A Rating Outlook Stable	Affirmed
	ST IDR	F1	Affirmed
	Viability	b+	Affirmed
	Support	1	Affirmed
	Support Floor	A	Affirmed

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Arab Bank for Investment and Foreign Trade PJSC	EU Issued

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