MOODY'S INVESTORS SERVICE

CREDIT OPINION
8 July 2020

Update

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RATINGS

Sharjah Islamic Bank PJSC

Domicile	United Arab Emirates
Long Term CRR	A2
Type	LT Counterparty Risk Rating - 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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Sharjah Islamic Bank PJSC

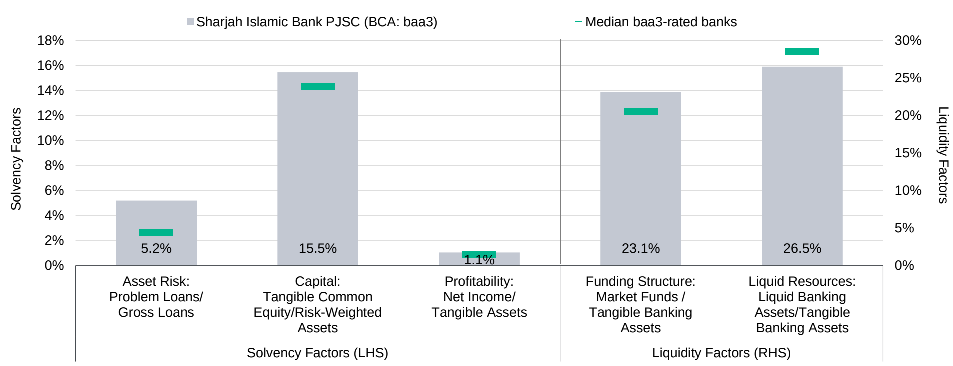
Update to credit analysis

Summary

Sharjah Islamic Bank PJSC's (SIB) A3 long-term issuer rating reflects its baa3 Baseline Credit Assessment (BCA) and our assessment of a very high probability of support from the United Arab Emirates government (UAE; Aa2 stable), in case of need. This reflects the bank's 37.5% direct and indirect ownership by the Government of Sharjah (Baa2 stable) and the UAE authorities' track record of support for the country's banks in case of need.

Sharjah Islamic Bank's baa3 BCA reflects its (1) sound regulatory capital; (2) stable funding profile and (3) sound liquidity buffers mitigating relatively high levels of market funding. These considerations are moderated by the bank's (1) progressive decline in core equity buffers amid a deteriorating operating environment in the UAE as capital was deployed to grow its franchise in recent years; (2) risks associated with its relatively weak asset quality and (3) modest profitability with sizeable real estate investment activities, which we consider inherently volatile.

Exhibit 1
Rating Scorecard - Key financial ratios



The problem loan and profitability ratios are the weaker between the average three-year and the latest interim ratios or the latest interim ratio. The capital ratio is the latest reported figure. The funding structure and liquid resources ratios are the latest year-end figures.
Source: Moody's Financial Metrics

Credit strengths

» Sound regulatory capital buffers albeit declining core equity

» Relatively stable funding profile and sound liquid resources which mitigate the bank's market funding reliance

» Government ownership, which supports our view that the bank would receive support in case of need

Credit challenges

» Declining core capital buffers

» Exposure to medium-sized corporates and high-net-worth individual (HNWI) clients' investments continues to drive relatively weak asset quality

» Modest profitability with exposure to inherently volatile real estate investment activities

» Deteriorating operating environment in the UAE

Rating outlook

The negative outlook captures ongoing downward pressure on the solvency profile of the bank. This reflects significantly declining core capital buffers against the backdrop of the bank's relatively weak asset risk, with high direct and indirect exposure to real estate amid a deteriorating economic environment in the UAE and modest profitability due to margin pressure, low efficiency and volatile core earnings.

Factors that could lead to an upgrade

Although not expected in the near-term given the negative outlook assigned to the bank's long term ratings, upward pressure on SIB's ratings could develop from a combination of (1) higher core capital buffers, (2) a material reduction in sector concentrations and direct real estate holdings, (3) a significant decline in its core earnings volatility and, (4) a material decrease in its market funding.

Factors that could lead to a downgrade

Downward pressure on SIB's ratings, as captured by the negative outlook, could develop from (1) core capital buffers continuing to decline or remaining unchanged, (2) continued core earnings volatility (3) increased market funding reliance and/or (4) any deterioration in asset quality.

Key indicators

Exhibit 2

Sharjah Islamic Bank PJSC (Consolidated Financials) [1]

	03-20[2]	12-19[2]	12-18[2]	12-17[3]	12-16[3]	CAGR/Avg.[4]
Total Assets (AED Million)	49,250.4	46,390.5	44,745.5	38,288.5	33,539.2	12.5[5]
Total Assets (USD Million)	13,408.2	12,629.6	12,181.8	10,424.9	9,131.5	12.5[5]
Tangible Common Equity (AED Million)	5,624.6	5,669.3	5,475.2	5,558.8	4,885.7	4.4[5]
Tangible Common Equity (USD Million)	1,531.3	1,543.4	1,490.6	1,513.5	1,330.2	4.4[5]
Problem Loans / Gross Loans (%)	4.9	5.1	5.5	5.3	6.7	5.5[6]
Tangible Common Equity / Risk Weighted Assets (%)	15.5	17.3	17.1	19.7	20.4	18.0[7]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	21.3	19.9	20.3	18.2	20.5	20.0[6]
Net Interest Margin (%)	1.8	--	2.2	--	1.8	1.9[6]
PPI / Average RWA (%)	1.4	1.6	1.6	2.1	--	1.7[7]
Net Income / Tangible Assets (%)	1.1	1.1	1.1	1.2	1.4	1.2[6]
Cost / Income Ratio (%)	52.3	52.6	55.8	48.0	42.2	50.2[6]
Market Funds / Tangible Banking Assets (%)	19.5	23.1	27.4	25.4	28.2	24.7[6]
Liquid Banking Assets / Tangible Banking Assets (%)	23.5	26.5	26.8	21.1	26.6	24.9[6]
Gross Loans / Due to Customers (%)	93.2	96.1	96.6	102.4	98.8	97.4[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 because of the scale of reported amounts. [5]Compound annual growth rate (%) based on the periods for the latest accounting regime. [6]Simple average of periods for the latest accounting regime. [7]Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

Recent credit developments

The global spread of the coronavirus is resulting in simultaneous supply and demand shocks. We expect these shocks to materially slow economic activity, particularly in the first half of this year. The full extent of the economic costs will be unclear for some time. Fear of contagion will dampen consumer and business activity. The longer it takes for households and businesses to resume normal activity, the greater the economic impact. Fiscal and monetary policy measures will likely help limit the damage in individual economies. Policy announcements from fiscal authorities, central banks and international organisations so far suggest that policy response is likely to be strong in affected countries. The coronavirus outbreak will have a direct negative impact on the asset quality and profitability of banks, in some cases in a pronounced manner, for example for undiversified banks with material exposure to high-risk sectors and SMEs.

In the United Arab Emirates, we expect the coronavirus to cause a broad-based shock to the economy. Non-oil growth - a barometer of the activity of the private sector - has slowed to just 1.3% in 2018 and 0.8% in 2019 while it is expected to contract by 4.0% in 2020. Key sectors in the non-oil space already experiencing cyclical and structural headwinds are now exacerbated by the coronavirus outbreak and indirect implications of low oil prices which will disrupt the tourism, transportation, trade, real estate and retail sectors. We expect borrowers in those sectors to be the most affected, and SMEs to be particularly vulnerable to economic shocks.

Profile

Sharjah Islamic Bank PJSC (Sharjah Islamic Bank) is an Islamic bank based in the UAE. It was established in 1975 as a conventional bank (under the name National Bank of Sharjah), before converting to an Islamic bank in 2002 under its current name. The bank provides a range of Sharia-compliant banking, finance, and investment products and services to private individuals, financial institutions, companies and government entities. The bank operates mainly in Gulf Cooperation Council countries (where 93% of its total assets were located as of the end of December 2019) and has market shares of 1.6%, 1.5% and 1.5% in terms of total assets, net financing and deposits, respectively, in the UAE. As of March 2020, the bank reported consolidated assets of AED49.3 billion ($13.4 billion).

As of March 2020, the bank operated in the UAE through a network of 35 branches. The bank's shares have been listed on the Abu Dhabi Securities Exchange (ticker: SIB) since 2004. As of December 2019, the Government of Sharjah directly and indirectly owned 37.55% of the bank's total outstanding share capital.

For more information on the bank, please see Issuer Profile - Sharjah Islamic Bank. For more information on the UAE banking system, please see Banking System Outlook - United Arab Emirates.

Detailed credit considerations

Exposure to medium-sized corporates and HNWIs' investments continues to drive relatively weak asset quality; direct real estate investments also add market risk

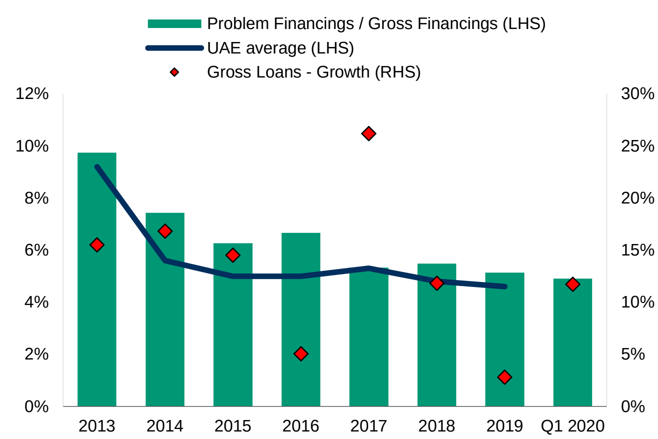
As of March 2020, Sharjah Islamic Bank's problem financings-to-gross financings ratio stood at 4.9% (5.1% in 2019). While this has improved from around 10% in 2013, it is slightly higher than the UAE average of around 4.6%, principally as a result of the bank's exposure to HNWIs. In addition, the bank's problem financing provisioning coverage increased in recent years and stood at a sound 82.8% of problem financings as of year-end 2019 before dropping to 78.2% in the first three months of 2020.

We expect Sharjah Islamic Bank's asset quality to remain weak, given that the deteriorating operating environment in the UAE - on the back of the double blow from the coronavirus induced economic disruption and prolonged low oil prices - will affect the creditworthiness of the medium-sized enterprises and corporates to which it is exposed. Moreover, the bank's asset-quality metrics continue to reflect its exposure to legacy impaired financings of high net-worth individuals (HNWIs). Despite these considerations, Moody's recognizes that the bank's exposure to Sharjah government related entities is a partial mitigating factor to asset risk which was around 29% of net financings as at the end of December 2019 (down from 32% in 2013).

We expect the bank's increasing lending concentrations to the construction and real estate sectors to continue to pose downside risks to its asset quality, given the cyclical nature of these sectors and the current context in which real estate prices are still in a correction phase in the UAE. As at year-end 2019, the bank's funded exposure to such sectors represented 134% of its tangible common equity (65% in 2017) and 29% of its gross loans while both figures go up to around 163% of TCE and 35% of gross loans when including financings to HNWIs, a material portion of which involves real estate as end use or collateral.

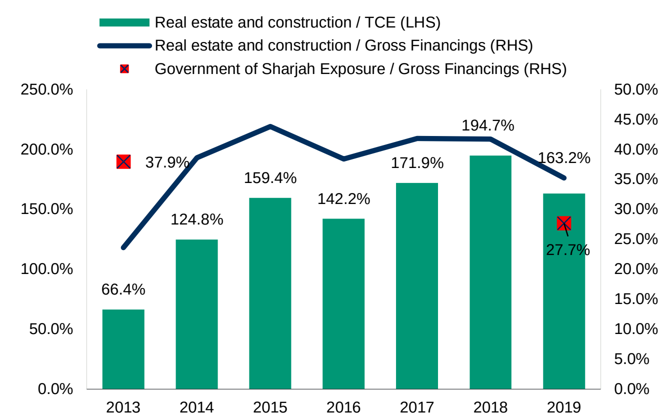
We also expect Sharjah Islamic Bank's direct investments in real estate to continue to expose the bank to market risk. Given the size and illiquid nature of these exposures (generated through the bank's real estate development subsidiary), the firm's problem financing ratio does not fully reflect its asset risk. Such exposures accounted for around 6.8% of the bank's total assets and 59.3% of its TCE as of March 2020 (49% in 2017).

Exhibit 3
SIB asset quality



Source: Sharjah Islamic Bank's financial statements, Moody's Investors Service

Exhibit 4
SIB asset concentrations



Note: Real estate and construction includes HNWIs
Source: Sharjah Islamic Bank's financial statements, Moody's Investors Service

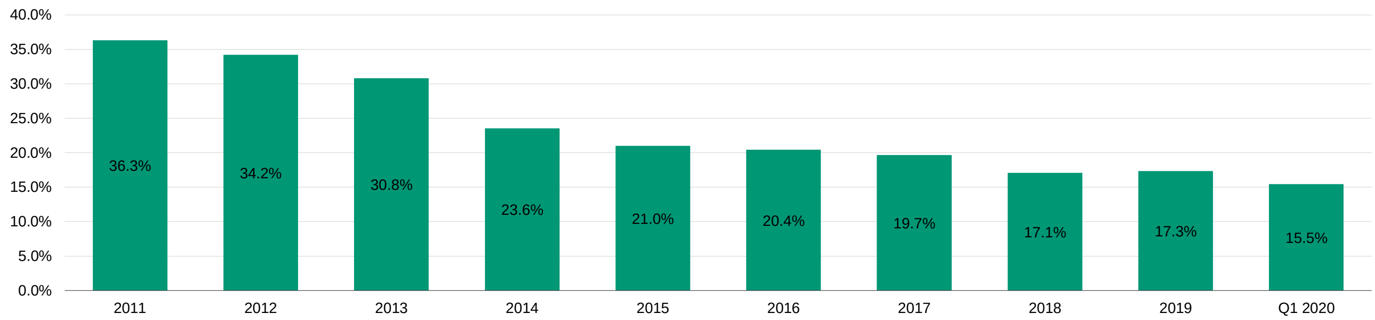
Sound regulatory capital but declining core equity

Sharjah Islamic Bank's regulatory capital adequacy ratios remain sound (tier 1 and capital adequacy ratios at 19.9% and 21.1% as of March 2020 above minimum regulatory requirements, respectively). However, core equity - although still comparing favorably to banks that are similarly rated on a standalone basis - has declined significantly in recent years amid a deteriorating operating environment in the UAE as the bank deployed capital to grow its franchise, and we expect financing growth to exert further downward pressure going forward.

The bank's core capitalisation, as measured by its tangible common equity (TCE) to risk-weighted assets ratio, decreased to 15.5% as of March 2020 from 20.4% in 2016, reflecting (1) above market financing growth at a compounded annual rate of around 14% during 2016-2019; and (2) the AED295 million capital impact from the adoption of IFRS 9 accounting standards during 2018. Although Sharjah Islamic Bank's regulatory capital is expected to remain sound underpinned by a recent Additional Tier 1 (AT1) sukuk issuance, the bank's core equity has declined significantly. This downward trend comes at a time when the economic environment in the UAE is deteriorating, with pockets of increasing asset risk, particularly in the real estate sector and the medium-sized enterprises segment, to which the bank is exposed.

In line with the local regulatory framework, AT1 capital instruments do not carry mandatory point of non-viability triggers and hence are not included in Moody's capital calculations. Total loss absorption capacity at SIB as measured by problem loans as a percentage of shareholders' equity and financing loss reserves stood at 21.4% as of March 2020 (19.6% UAE average).

Exhibit 5
SIB tangible common equity to risk weighted assets



Sources: Sharjah Islamic Bank's financial statements, Moody's Investors Service

Modest profitability with exposure to volatile real estate investment activities

We expect Sharjah Islamic Bank to continue to post modest net profitability owing to lower than market average margins and efficiency indicators, volatility in core earnings and increased provisioning in the context of preexisting deteriorating domestic operating conditions that are exacerbated by the coronavirus outbreak and prolonged low oil prices.

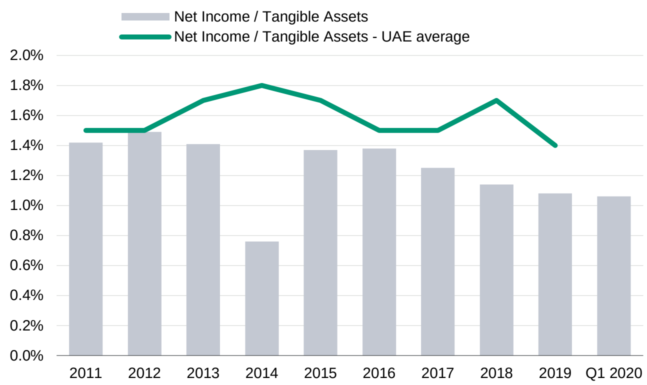
Although broadly stable, the bank's net income to tangible assets ratio has been at around 1.1%-1.4% since 2014 (1.1% in the first three months of 2020), which is lower than the 1.4%-1.8% UAE average over the same period. This reflects the net profit margin[1] tightening to 1.8% as of March 2020 from 2.7% in 2014 which is mainly due to a rise in funding costs to 2.2% in March 2020 from 1.3% in 2014 outpacing the asset repricing efforts of the bank over the same period. Going forward, we expect the net profit margin to remain subdued against a backdrop of decreasing interest rates.

Also, the bank's core earnings continue to be exposed to volatility from the value of its real estate investments (6.8% of total assets as of March 2020) - 82% of which is mark-to-market held and subject to annual valuations that are largely dependent on market conditions. This has contributed to considerable volatility in Sharjah Islamic Bank's pre-provision profitability, which has fluctuated between 1.2% and 2.6% (1.0% for the first three months of 2020) as a proportion of average total assets since 2014.

In addition, Sharjah Islamic Bank's cost efficiency has been structurally weaker than local peers with a Moody's cost-to-income ratio at 52.3% as of March 2020 which compares unfavorably to the UAE average at 35%. However, the bank aims to improve its cost efficiency profile through investments in its IT systems and digital offering as well as branch network rationalisation with the objective of achieving a cost to income ratio trending towards the UAE average.

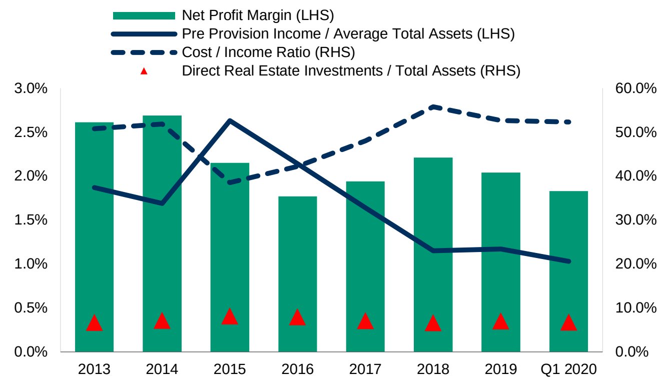
Going forward, this modest level of net profitability presents a reduced scope to support the bank's internal capital generation relative to the current pace of its balance sheet expansion - which in turn is contributing to the negative outlook on the bank's ratings.

Exhibit 6
SIB's net profitability is weaker than locally rated peers' average



Source: Rated UAE banks' financial statements, Moody's Investors Service

Exhibit 7
SIB core profitability indicators



Note: The net profit margin and pre provision income March-end 2020 ratios are annualised.
Source: Sharjah Islamic Bank's financial statements, Moody's Investors Service

Sound liquidity buffers mitigate reliance on market funding

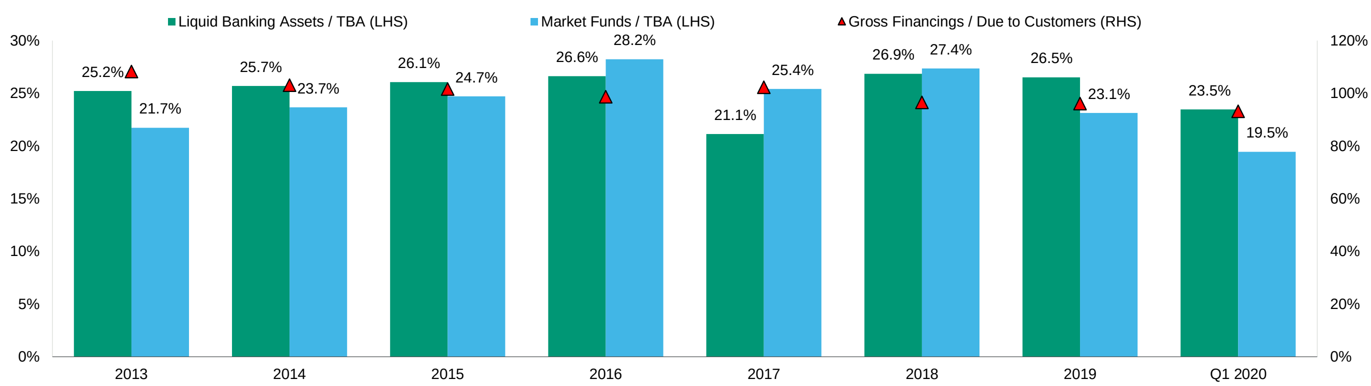
The bank's baa3 BCA captures its relatively high reliance on market funding which is however balanced by sound levels of liquid resources against the confidence sensitive nature of such funding.

We expect the bank to continue to exhibit reliance on capital market and interbank market funding. Although market funding tends to be relatively confidence and price sensitive, the sukuk portion of the bank's market funding helps diversify its funding base and reduce its asset-liability maturity mismatch.

As of March 2020, the bank's market funds accounted for 19.5% of its tangible banking assets (23.1% as of December 2019). This market funding is mainly sourced through issuances from the bank's $3 billion Trust Certificates Issuance Programme, and interbank funding (around 48% of total market funding as of year-end 2019). During the first three months of 2020, the bank's deposit base expanded by 15.3% while net financing increased by 12.2%, leaving the net financing to deposits ratio at 89.6% (92.1% as of December 2019).

Mitigating this reliance on wholesale funding, the bank maintains a sound cushion of liquid resources. As of March 2020, the bank's liquid banking assets represented 23.5% of tangible banking assets (26.5% as of December 2019).

Exhibit 8
SIB funding and liquidity ratios



Source: Sharjah Islamic Bank's financial statements, Moody's Investors Service

ESG considerations

In line with the banking sector, SIB has a low exposure to environmental risks as direct lending to the hydrocarbon sector is fairly limited (see our Environmental risk heatmap for further information). However, given the sizeable contribution of the hydrocarbon industry to the UAE economy and the arid nature of the country, bank's indirect exposure to the hydrocarbon sector and to the local climate may increase their vulnerability to environmental risks. As a major oil exporter, the UAE's environmental risks are predominantly derived from carbon transition. Under a Sustainable Development scenario of hydrocarbon demand, which assumes energy consumption and production patterns consistent with fulfilling sustainable development goals, the UAE's credit profile would face downward pressure, although only over the longer-term and with sizeable buffers to provide support. The UAE is also one of the world's top ten most arid states, and rapid growth in recent decades has further increased challenges surrounding water sustainability, with majority of the country's water produced by desalination plants, which are highly energy intensive. Transmission channels of environmental risks for UAE banks include, over the long-term, the credit risk of borrowers with stranded assets, as well as the gradual incorporation of environmental considerations in the credit process of international investors extending funding to UAE banks.

The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage due to product mis-selling or other types of misconduct is a further social risk. Societal trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services and increasing information technology cost. Overall, we consider banks to face moderate social risks. See our Social risk heatmap for further information.

Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven. Governance is highly relevant for SIB, as it is to all banks operating in the GCC. In the GCC, governments along with government related issuers tend to have a large footprint on the overall economy. Consequently, they are often among the largest borrowers, depositors and in some case shareholders in the largest banks across the region. Corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Government ownership and UAE authorities' track record of support underpin our view that Sharjah Islamic Bank would receive support in case of need

Sharjah Islamic Bank's A3 issuer rating incorporates a very high likelihood of government support in case of need, which translates into a three-notch uplift from its baa3 BCA, based on (1) Sharjah government's 37.55% direct and indirect ownership stake through the Sharjah Asset Management LLC and the newly formed Sharjah Social Security Fund, and (2) UAE's strong track record of supporting banks in times of stress.

Counterparty Risk Rating (CRR)

CRRs are opinions of the ability of entities to honor the uncollateralised 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. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that, in the event of a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivative transactions and the uncollateralised portion of liabilities under sale and repurchase agreements.

SIB's CRRs are positioned at A2/P-1.

We consider UAE a jurisdiction with a non-operational resolution regime. For non-operational resolution regime countries, the starting point for the CRR is one notch above the bank's Adjusted BCA. In the case of SIB, and in line with our support assumptions on deposits, the CRR benefits from a three-notch uplift of government support. The bank's CRR is, therefore, one notch above the issuer rating.

Counterparty Risk (CR) 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, 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 (for example, swaps), letters of credit, guarantees and liquidity facilities.

SIB's CR Assessments are positioned at A2(cr)/P-1(cr).

The CR Assessment, prior to government support, is positioned one notch above the Adjusted BCA of baa3 and therefore above the issuer rating, 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, minimise losses and avoid disruption of critical functions.

The CR Assessment also benefits from three notches of systemic support, in line with our support assumptions on deposits. This reflects our view that any support provided by government authorities to a bank that 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 local system averages quoted in the report are updated as of the end of December 2019, unless otherwise stated, and are based on available audited system metrics. Bank specific figures originate from banks' 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 document Financial Statement Adjustments in the Analysis of Financial Institutions, published on 9 August 2018.

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 9

Sharjah Islamic Bank PJSC

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

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	5.2%	ba1	↓	b3	Sector concentration	Market risk
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	15.5%	a2	↓	a3	Expected trend	
Profitability						
Net Income / Tangible Assets	1.1%	baa2	↓	baa3	Earnings quality	
Combined Solvency Score		baa2		ba1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	23.1%	baa3	←→	ba2	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	26.5%	baa2	↓	ba1	Expected trend	
Combined Liquidity Score		baa3		ba2		
Financial Profile				ba1		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Aa2		
BCA Scorecard-indicated Outcome - Range				baa3 - ba2		
Assigned BCA				baa3		
Affiliate Support notching				0		
Adjusted BCA				baa3		

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	baa2	3	A2	A2
Counterparty Risk Assessment	1	0	baa2 (cr)	3	A2(cr)	

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

Source: Moody's Investors Service

Ratings

Exhibit 10

Category	Moody's Rating
SHARJAH ISLAMIC BANK PJSC	
Outlook	Negative
Counterparty Risk Rating	A2/P-1
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A2(cr)/P-1(cr)
Issuer Rating	A3
ST Issuer Rating	P-2
SIB SUKUK COMPANY III LIMITED	
Outlook	Negative
Bkd Senior Unsecured	A3

Source: Moody's Investors Service

Endnotes

1 Net profit margin as per Moody's calculation

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CLIENT SERVICES

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

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