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## Sharjah Islamic Bank

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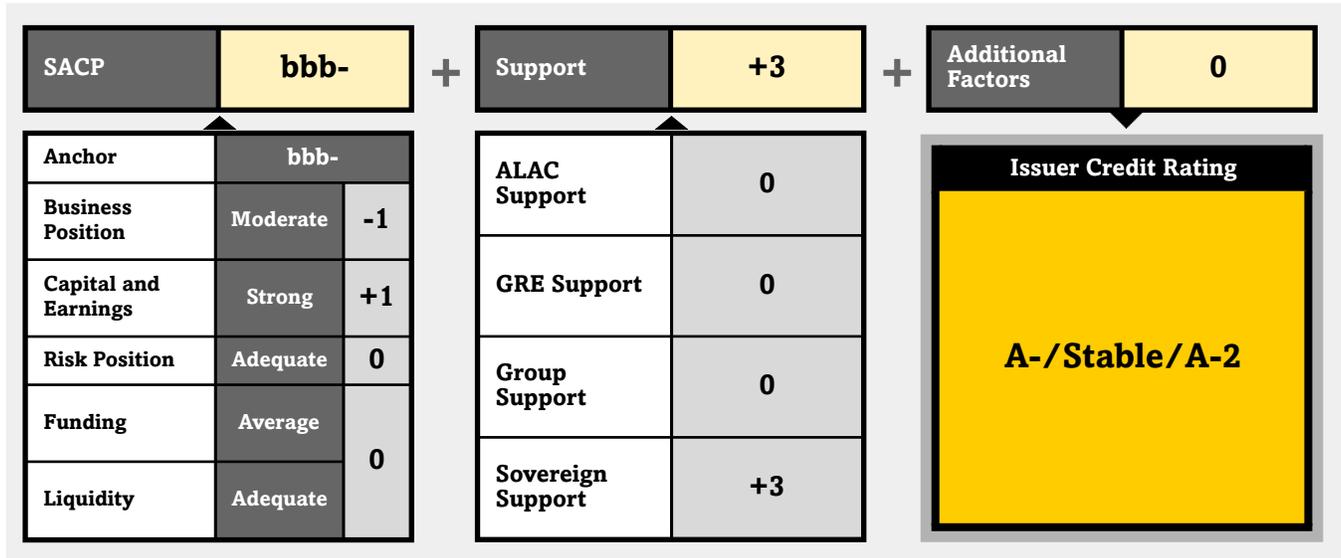
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# Sharjah Islamic Bank



## Credit Highlights

### Overview

Key strengths	Key risks
Strong capitalization.	High share of loans benefitting from deferrals.
High systemic importance in the United Arab Emirates (UAE).	Sizable lending exposure to the real estate and construction sectors.
Strong relationship with the government of Sharjah.	Limited geographic diversification.

**Sharjah Islamic Bank's (SIB's) capitalization will remain strong.** We expect that SIB's risk-adjusted capital (RAC) ratio before concentration adjustments will remain at 11.5%-12.0% over the next 12-24 months. We factor an average cost of risk of above 100 basis points (bps) over the next two to three years in our base-case forecast, and we expect the share of stage 3 loans will revert to around 5.5%. We also expect the bank will maintain stage 3 coverage by specific provisions of about 60%--broadly on par with the UAE market average.

**SIB's credit growth will outpace that of its peers.** We expect SIB will continue expanding at a faster pace than its domestic peer group, with financings increasing by 7%-8% per year as it captures market share from other Sharjah-based banks. Like 2020, we believe a significant portion of growth will be linked to government-related entities (GREs) in Sharjah, and to a lesser extent Dubai.

**Loan deferrals will remain a source of uncertainty.** We expect some deterioration in asset-quality indicators at UAE banks as regulatory forbearance measures are progressively lifted. On June 30, 2021, about 11% of SIB's corporate financings and 4% of its retail book benefitted from deferrals. We understand that most borrowers continued to service their debt and that the bank recovered some payments that were not collected in 2020 over the first half of 2021. Still, we observe some deterioration in the quality of these deferrals with Group 2 exposure (borrowers expected to face substantial changes in their creditworthiness) at 3.5% of the total corporate book.

**Outlook: Stable**

The stable outlook reflects our view that the bank's business and financial profiles will remain broadly unchanged over the next 12-24 months, despite pressure on its operating environment and our expectation that asset-quality indicators will slightly weaken.

**Downside scenario**

We could consider a negative rating action if we observe higher-than-expected deterioration in asset quality or weaker-than-expected capitalization, signaled by the RAC ratio dropping below 10%, which may come from faster-than-expected growth. We may also take a negative rating action if the creditworthiness of Sharjah's government, the bank's largest counterparty, comes under further pressure.

**Upside scenario**

A positive rating action is remote in the next 12-24 months, since it would require SIB to materially strengthen both its franchise and capitalization, with RAC sustainably exceeding 15%.

**Key Metrics****Sharjah Islamic Bank--Key Ratios And Forecasts**

(%)	--Fiscal year ended Dec. 31--				
	2019a	2020a	2021f	2022f	2023f
Growth in operating revenue	5.5	2.3	9.6-11.8	5.6-6.8	5.0-6.2
Growth in customer loans	2.7	16.4	7.2-8.8	7.2-8.8	5.4-6.6
Growth in total assets	3.7	15.5	6.0-7.4	6.6-8.0	5.2-6.4
Net interest income/average earning assets (NIM)	2.3	2.2	2.1-2.3	2.1-2.3	2.1-2.3
Return on average common equity	9.8	7.1	6.9-7.6	9.6-10.6	9.4-10.4
Return on assets	1.2	0.8	0.7-0.8	0.9-1.1	0.9-1.1
New loan loss provisions/average customer loans	0.4	0.9	1.2-1.3	0.8-0.9	0.9-1.0
Gross nonperforming assets/customer loans	5.1	4.9	5.8-6.4	5.3-5.9	5.3-5.8
Risk-adjusted capital ratio	15.6	12.3	11.7-12.3	11.4-12.0	11.2-11.7

All figures are S&P Global Ratings-adjusted. a--Actual. f--Forecast.

**Anchor: 'bbb-' For Banks Operating Only In The UAE**

*Our starting point for a commercial bank operating in the UAE is 'bbb-'.* The UAE has a wealthy economy with strong fiscal and external positions. The strength of the government's net asset position has helped counteract the negative impact of lower oil prices on economic growth since late 2015. The COVID-19 pandemic, lower oil prices, and continued pressure on the real estate sector have increased risks for UAE banks, and we expect the banking sector's problem loans to increase further once the regulatory forbearance measures are lifted and banks start to account for the impact of the economic shock. However, we expect this process to be gradual, minimizing the impact on the banking system. Although UAE banks traditionally operate with healthy profitability metrics, low interest rates have negative consequences for bank margins. We therefore expect the banking sector's profitability will remain lower for

longer.

After the pandemic started, the UAE Central Bank implemented its Targeted Economic Support Scheme (TESS), which helped ease the pressure on corporate issuers and small and midsize enterprises. However, the scheme did not reduce credit risk on the banking system's balance sheet. The scheme included a provision that allows banks not to classify deferred exposures as Stage 2 and Stage 3. Rather, banks have classified deferrals into two groups: Group 1 (exposures to clients that are temporarily and mildly impacted); and Group 2 (exposures to clients that are significantly impacted and could see potential stage migrations) and disclosed the information, which we view as positive. At year-end 2020, 12% of the top 10 banks' exposures were classified as Group 1 and 2% as Group 2. UAE banks enjoy a good funding profile. Public-sector and government depositors provide more than 30% of resident deposits. We expect these entities to withdraw some deposits in 2021 but do not see any immediate liquidity challenges for banks.

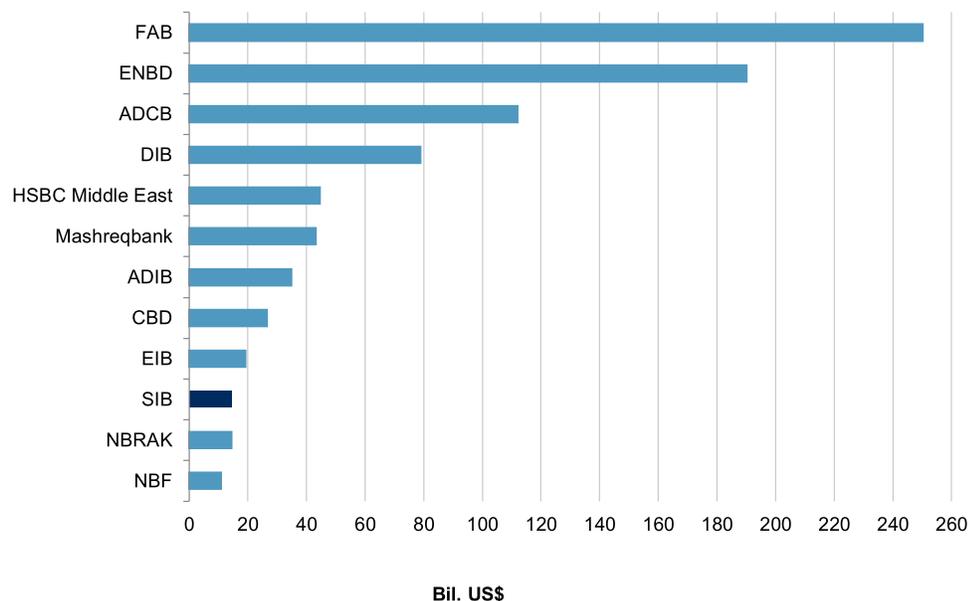
## **Business Position: Strong Presence In Sharjah But Challenger In The UAE Market**

*A small financial institution with an entrenched niche.* SIB is a smaller institution in the UAE market with total assets representing around 1.6% of systemwide total. However, it ranks fourth among local Islamic banks with a share of around 7%-8% in UAE Islamic-finance market at year-end 2020 and has the role of the flagship financial institution in the emirate of Sharjah. The government of Sharjah owns 37.6% of the bank and it draws around 60% of its revenue from business in Sharjah. This position in Sharjah will help the bank to outpace its peers in terms of growth as it takes business from weaker banks.

*Lending to the Sharjah government and GREs will continue to be key exposure of the bank.* Exposure to bank's major shareholders and other related parties (mostly various government vehicles) stands at around 30% of the bank's financing. We believe that, given projected deficits for the government of Sharjah, the bank will continue lending to the emirate and its GREs, further linking its intrinsic credit quality with those of the Sharjah government.

**Chart 1****SIB Has Modest Size In Domestic Context**

Largest UAE banks by total assets



Source: S&amp;P Global Ratings.

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**Capital And Earnings: Strong In A Global Context**

*We see capitalization as a positive rating factor for SIB.* This reflects our expectation that the bank's projected RAC ratio will remain at 11.5%-12.0% over the next 12-24 months, as compared with 13.8% at year-end 2020. Although the bank significantly expanded its lending in 2020, most of the growth was spurred by lending to government authorities, in particular the government of Sharjah. We expect SIB will continue expanding at a faster pace than its peer group, with financing expanding by 7%-8% per year as it captures market share from other Sharjah-based banks.

**Risk Position: Concentrated Exposures Similar To Peers**

*Similar to other banks in the Gulf Cooperation Council, a key source of risk for SIB lies in high single-party concentration.* The 20 largest funded and unfunded corporate gross credit exposures represented around 30% of the bank's loan book as of year-end 2020 (excluding those to the government of Sharjah and its GREs). Similar to its peers, SIB exhibits high real estate and construction exposures. At year-end 2020, loans to these sectors comprised about 23% of the loan book, compared with a UAE banking industry average of about 20%. This number is further inflated by bank's exposure to high net worth individuals which is frequently linked to underlying real estate risks.

**SIB's stock of problematic loans as a share of total loans is broadly commensurate with the systemwide average.**

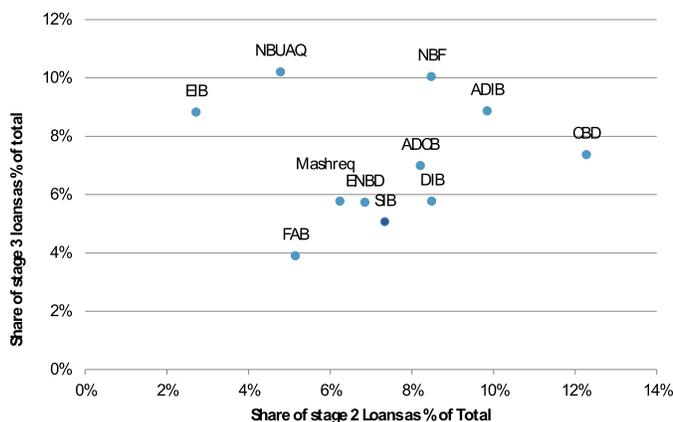
Although this is partially masked by the very high share of loans with deferred payments, the volume of Group 2 exposures (3.3% of total as of the second quarter) is manageable, and we believe the bank will be able to absorb the increase in Stage 2 and Stage 3 loans once the TESS-related waivers are lifted. We also note that SIB's coverage of existing Stage 3 loans is broadly on par with the country average.

**SIB's focus on the public sector helped it to navigate market pressure in 2020.** We nevertheless expect some deterioration in asset-quality indicators because regulatory forbearance measures are progressively lifted. At mid-2021 around 11% of the loan book continued to benefit from deferrals. We factor an average cost of risk of above 100 bps over the next two to three years in our base-case forecast and expect the share of Stage 3 loans will revert to the 5.5% range. We also expect the bank will maintain Stage 3 coverage by specific provisions of about 60%, broadly on par with UAE market average.

**SIB's stand-alone credit profile remains closely linked to that of the government of Sharjah.** With 28% of credit risk exposures being to sovereign risk (mostly the government of Sharjah) and sizable exposure to GREs on top of that, SIB's credit quality is tightly linked to that of Sharjah (BBB-/Stable/A-3). Deterioration in the government's financial profile will likely put pressure on the bank's SACP as well.

### Chart 2

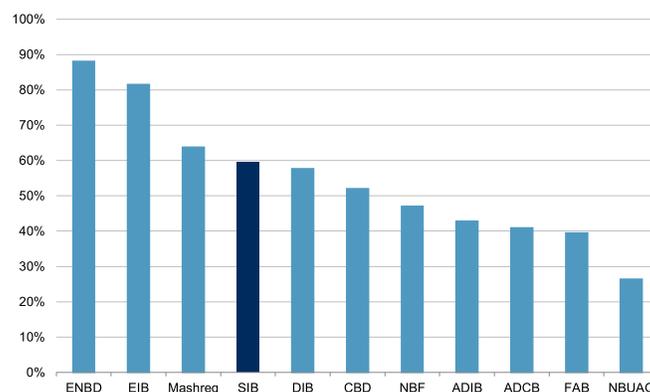
**SIB's Asset Quality Is Commensurate With Domestic Peers**  
Asset quality metrics for selected UAE banks as of Q1 2021



Source: S&P Global Ratings.  
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### Chart 3

**SIB's Stage 3 Assets Are Reasonably Provisioned in Domestic Context**  
Coverage of stage 3 loans and financings of selected UAE banks on Q1 2021



Source: S&P Global Ratings.  
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## Funding And Liquidity: Deposit-Funded Franchise

SIB's funding profile is in line with its domestic peers. The bank funds itself predominantly from domestic customer deposits. As of March 31, 2021, SIB's loan-to-deposit ratio stood at 82.6% and the ratio of stable funding resources to funding needs was a healthy 112%, according to our calculations. SIB enjoys steady access to deposits from the government of Sharjah and its cash-rich related entities, thanks to its privileged relationship. Like most banks in the Gulf Cooperation Council, SIB exhibits funding concentrations. Its ratio of top 20 depositors to total deposits remained high at 36% at year-end 2020, and mainly comprised deposits from government and public-sector entities.

The bank has a relatively liquid balance sheet. Broad liquid assets covered short-term wholesale funding needs by 1.82x and net broad liquid assets covered 14.2% of short-term customer deposits as of June 30, 2021. The latter number, although low in the global context, is nevertheless commensurate with many other Islamic peers.

## Support: Three Notches Of Uplift For Systemic Importance

The issuer credit rating on Sharjah Islamic Bank is three notches higher than its SACP, reflecting our view of a high likelihood of extraordinary government support for SIB if needed. This is in line with the bank's high systemic importance in the UAE. SIB is the fourth-largest Islamic bank in the UAE, with a market share of 7%-8% in terms of Islamic loans and deposits. The assessment also reflects the bank's strong relationship with the government of Sharjah, which owns 37.6% of SIB. We also consider the UAE authorities as highly supportive toward their banking system, with a strong track record of support provision.

## Ratings Above The Sovereign

We apply the sovereign stress test for SIB at the UAE level and not at the level of Sharjah, where the bank has material exposure. This is because we view the UAE as the relevant level of jurisdiction for Sharjah's banks (see "Guidance | Criteria | Financial Institutions | General: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions", published Feb. 13, 2019, on Ratings Direct).

## Environmental, Social, And Governance

We believe environmental, social, and governance (ESG) credit factors influence SIB's credit quality to a similar extent as industry and country peers. Although we estimate that the bank has relatively limited direct lending to sectors exposed to energy transition risk, the indirect exposure (via the overall dependence of the UAE economy on hydrocarbons) is higher. Social risks are not significantly different from those of its industry peers. Sharjah's government directly and indirectly owns 37.6% of the bank, which helps SIB maintain key account relationships with the Sharjah government and GREs. That said, we believe the ownership structure has not resulted in any governance weakness. In the past few years, SIB has not been involved in any material reputational controversies, has not experienced any incident related to noncompliance with laws and regulations, and has not been subject to any significant legal or regulatory fines or settlements. Finally, we believe that bank regulation in the UAE is less focused on consumer protection than in more developed economies, meaning SIB's exposure to mis-selling penalties or other retail conduct risks is rather limited.

## Key Statistics

**Table 1**

<b>Sharjah Islamic Bank Key Figures</b>					
<b>--Year-ended Dec. 31--</b>					
<b>(Mil. AED)</b>	<b>2021*</b>	<b>2020</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>
Adjusted assets	54,351.2	53,600.8	46,390.5	44,745.5	38,288.5
Customer loans (gross)	30,638.4	30,556.4	26,261.3	25,580.5	22,837.8
Adjusted common equity	5,646.9	5,405.6	5,389.8	5,173.7	5,260.1
Operating revenues	687.1	1,247.4	1,219.9	1,156.4	1,155.1
Noninterest expenses	269.8	561.5	585.4	614.2	556.2
Core earnings	289.5	430.1	537.7	505.3	450.1

\*Data as of June 30. AED--UAE dirham.

**Table 2**

<b>Sharjah Islamic Bank Business Position</b>					
<b>--Year-ended Dec. 31--</b>					
<b>(%)</b>	<b>2021*</b>	<b>2020</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>
Loan market share in country of domicile	N/A	N/A	N/A	N/A	N/A
Deposit market share in country of domicile	N/A	N/A	N/A	N/A	N/A
Total revenues from business line (currency in millions)	687.1	1,259.2	1,227.7	1,161.4	1,182.7
Commercial banking/total revenues from business line	56.4	52.9	45.6	51.1	61.6
Retail banking/total revenues from business line	25.9	28.2	30.9	26.3	23.8
Commercial & retail banking/total revenues from business line	82.3	81.1	76.5	77.4	85.4
Trading and sales income/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Corporate finance/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Brokerage/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Insurance activities/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Agency services/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Payments and settlements/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Asset management/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Other revenues/total revenues from business line	17.7	18.9	23.5	22.6	14.6
Investment banking/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Return on average common equity	10.0	7.1	9.8	9.4	9.2

\*Data as of June 30. N/A--Not applicable.

**Table 3**

<b>Sharjah Islamic Bank Capital And Earnings</b>					
<b>--Year-ended Dec. 31--</b>					
<b>(%)</b>	<b>2021*</b>	<b>2020</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>
Tier 1 capital ratio	19.6	19.5	21.6	16.5	19.5
S&P Global Ratings' RAC ratio before diversification	N/A	13.8	15.6	12.3	15.7
S&P Global Ratings' RAC ratio after diversification	N/A	7.9	11.9	9.5	11.1
Adjusted common equity/total adjusted capital	75.5	75.2	75.2	100.0	100.0
Double leverage	N.M.	N.M.	N.M.	N.M.	N.M.
Net interest income/operating revenues	78.3	78.1	73.6	51.8	55.1

Table 3

Sharjah Islamic Bank Capital And Earnings (cont.)					
	--Year-ended Dec. 31--				
(%)	2021*	2020	2019	2018	2017
Fee income/operating revenues	21.7	14.9	15.3	17.2	17.9
Market-sensitive income/operating revenues	N/A	3.6	4.8	25.7	21.7
Cost to income ratio	39.3	45.0	48.0	53.1	48.2
Preprovision operating income/average assets	1.5	1.4	1.4	1.3	1.7
Core earnings/average managed assets	1.1	0.9	1.2	1.2	1.3

\*Data as of June 30. N/A--Not applicable. N.M.--Not meaningful.

Table 4

Sharjah Islamic Bank--Risk-Adjusted Capital Framework Data					
(AED 000s)	Exposure*	Basel III RWA	Average Basel III RW (%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
<b>Credit risk</b>					
Government and central banks	14,865,051.5	0.0	0.0	367,879.1	2.5
Of which regional governments and local authorities	0.0	0.0	0.0	0.0	0.0
Institutions and CCPs	9,902,483.3	0.0	0.0	4,703,679.5	47.5
Corporate	19,402,086.2	35,329,510.0	182.1	25,094,018.5	129.3
Retail	3,738,912.0	0.0	0.0	3,087,929.0	82.6
Of which mortgage	1,325,372.0	0.0	0.0	624,082.6	47.1
Securitization§	0.0	0.0	0.0	0.0	0.0
Other assets†	5,831,459.0	0.0	0.0	8,959,747.5	153.6
Total credit risk	53,739,992.0	35,329,510.0	65.7	42,213,253.6	78.6
<b>Market Risk</b>					
Equity in the banking book	1,070,139.0	0.0	0.0	9,621,480.7	899.1
Trading book market risk	--	111,831.0	--	167,746.5	--
Total market risk	--	111,831.0	--	9,789,227.2	--
<b>Operational risk</b>					
Total operational risk	--	2,262,468.0	--	2,338.9	--
	Exposure	Basel III RWA	Average Basel II RW (%)	S&P Global Ratings RWA	% of S&P Global Ratings RWA
<b>Diversification adjustments</b>					
RWA before diversification	--	37,703,809.0	--	52,004,819.8	100.0
Total diversification/concentration adjustments	--	--	--	39,004,747.3	75.0
RWA after diversification	--	37,703,809.0	--	91,009,567.1	175.0
		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings RAC ratio (%)
<b>Capital ratio</b>					
Capital ratio before adjustments		0.0	0.0	7,189,420.1	13.8

**Table 4**

Sharjah Islamic Bank--Risk-Adjusted Capital Framework Data (cont.)				
Capital ratio after adjustments†	0.0	0.0	7,189,420.1	7.9

\*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions.

‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets.

RW--Risk weight. RAC--Risk-adjusted capital. AED--UAE dirham. CCPs--Central counterparty clearing house. Sources: Company data as of Dec. 31, 2020, S&P Global Ratings.

**Table 5**

Sharjah Islamic Bank Risk Position					
	--Year-ended Dec. 31--				
(%)	2021*	2020	2019	2018	2017
Growth in customer loans	0.5	16.4	2.7	12.0	26.1
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	75.0	31.4	29.8	42.0
Total managed assets/adjusted common equity (x)	9.6	9.9	8.6	8.6	7.3
New loan loss provisions/average customer loans	0.8	0.9	0.4	0.2	0.7
Net charge-offs/average customer loans	0.3	0.2	1.6	(0.1)	(0.3)
Gross nonperforming assets/customer loans + other real estate owned	5.0	4.9	5.1	5.5	5.0
Loan loss reserves/gross nonperforming assets	88.2	86.2	82.8	104.0	99.8

\*Data as of June 30. N/A--Not applicable.

**Table 6**

Sharjah Islamic Bank Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2021*	2020	2019	2018	2017
Core deposits/funding base	76.4	74.5	72.0	68.7	70.0
Customer loans (net)/customer deposits	83.7	87.1	92.1	91.2	97.3
Long-term funding ratio	88.7	87.5	88.7	89.2	93.3
Stable funding ratio	109.1	104.2	107.2	106.1	106.4
Short-term wholesale funding/funding base	13.2	14.6	13.5	12.3	7.9
Broad liquid assets/short-term wholesale funding (x)	1.8	1.4	1.7	1.7	2.2
Net broad liquid assets/short-term customer deposits	14.2	8.4	13.7	12.2	13.9
Short-term wholesale funding/total wholesale funding	47.9	49.5	41.2	39.4	26.3
Narrow liquid assets/3-month wholesale funding (x)	N/A	1.7	1.9	2.5	2.1

\*Data as of June 30.

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And

Assumptions, Nov. 19, 2013

- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

### Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

### Ratings Detail (As Of August 16, 2021)\*

#### Sharjah Islamic Bank

Issuer Credit Rating A-/Stable/A-2

#### Issuer Credit Ratings History

25-Mar-2021 A-/Stable/A-2

26-Mar-2020 A-/Negative/A-2

27-May-2019 A-/Stable/A-2

#### Sovereign Rating

Abu Dhabi (Emirate of) AA/Stable/A-1+

#### Related Entities

##### SIB Sukuk Co. III Ltd.

Senior Unsecured A-

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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