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Industry Research

Kuwait Banking Industry

Report Contents

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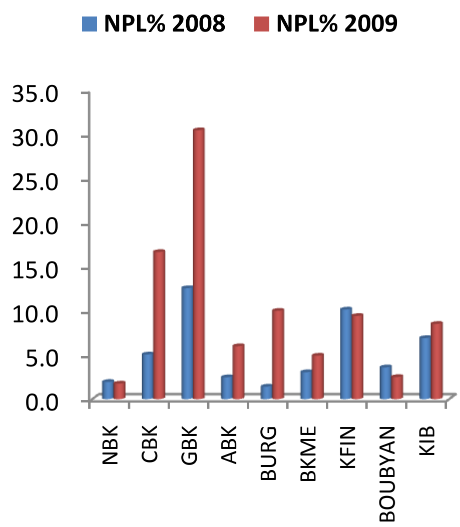
Summary

The global economic crisis starting in H208 weakened the Kuwaiti banking sector significantly. The banks have suffered from liquidity pressure, deterioration in asset quality, and mounting losses on account of higher impairment and provisions. This was further accentuated by a steep decline in GDP, and increased pressure on government finances.

The year 2010 would continue to be difficult for Kuwait banks as they continue to clean up their loan books, though positive signs of recovery are starting to show up. Kuwaiti banks are highly exposed to the real estate & investments sectors as well as to the default of al Saad & al Qusaibi groups during the past year, which is expected to remain weak in the near term. The banks' financial performance is further affected by an undiversified operating environment which is heavily reliant on the oil sector and the limited opportunities.

Kuwaiti banking industry remains challenging and is characterized by high competition among domestic banks. Banks like NBK, KFH, BKME and Al - Ahli bank have emerged stronger from the economic crisis though they all reported lower profits and increase in absolute NPLs, exception being NBK. Kuwaiti banks performance turnaround is increasingly affected by the contraction in the local economy and exposure to risky asset classes. More than 50% of the banking system loan portfolio is exposed to potentially risky sectors, including real estate, construction, lending for the purchase of securities and investment companies. This exposes Kuwaiti banks to significant market induced credit risk.



Specifically, the problem in Kuwaiti banks has been aggravated by the KD375m derivative loss in Gulf bank, exposure to real estate investments, and the increased provisions for exposure towards troubled Saudi groups. The government approved KWD1.5bn stimulus package to allow for bank capitalization and encourage loan extensions by guaranteeing 50% of up to KWD4bn in fresh loans. We believe that this relatively less interventionist approach would go a long way in strengthening decision making and risk management practices in Kuwaiti banks.

Snapshot as of FY2009	NBK	CBK	GBK	ABK	BURG	BKME	KFH	BOUBYAN	KIB
Size and Scale (KWD mn)									
Market Cap (as of 01-04-2010)	3,859	1,195	915	547	385	590	2,838	926	227
Net Profit	265.2	0.1	(28.0)	39.1	6.2	14.2	118.7	(51.6)	(8.2)
Total Assets	12,907	3,595	4,744	2,966	4,094	2,260	11,290	964	1,140
Total Equity	1,825	440	408	330	325	213	1,215	87	173
Customer Deposits	6,600	2,042	3,149	1,838	2,425	1,460	7,262	709	713
Gross Loans	8,113	2,772	3,769	2,171	2,364	1,648	6,809	683	909

Overview of the Banking Industry in Kuwait

Concentrated banking system & Government dominance……

The structure of the banking sector is fairly concentrated. The National Bank of Kuwait (NBK) is more than twice the size of the next largest, the Gulf Bank, in terms of assets and deposits. Together, they own around fifty percent of the assets of conventional banks and dispense around the same proportion of total banking credit. The impact of excessive government intervention in the economy in general and in the banking sector in particular, is in the form of administrative control, subsidized loans, equity injections and bail-outs. Another salient feature of Kuwaiti banks is the mixed nature of their ownership. Except for NBK, which is almost entirely owned by the private sector, the government is a shareholder in the rest of the banks. Another factor that disturbed the sector is the passage of the consumer loan bailout bill, which was rejected by the government; however, it will have a second round of vote during this year with uncertain outcome.

……… growing preference for Islamic banking

Kuwait has developed a preference for Islamic financial services over conventional ones, the profits from which have started to fade and is burdened with high debt levels driven by the crisis. Shariah-compliant financial services have shown healthy growth in during recent years, becoming a potential competitor for both conventional banks and investment houses. Hence conventional banks have been trying to acquire stakes in Islamic bank which was evident by NBK increasing its stake in Boubyan banks up to 40%. Moreover Boubyan is planning a 50% capital increase rights' issue which is expected to be subscribed by NBK.

Financial Performance of Kuwaiti Banks

Profits remain subdued

Kuwaiti banks profits continued to deteriorate as impairment charges increased for both loans and investments. The banking sector as a whole registered 15.0% growth in net profits to KWD 356m compared to KWD 309m in 2008, largely driven by lower losses in Gulf bank. As a matter of fact, provisioning and impairment of investments continue to weigh heavily on Kuwaiti banks profitability. The nine listed banks in this sector achieved variable performance as NBK, the largest Kuwaiti bank, was the only one to post net profit growth in 2009 by 3.8%. There are four banks that posted a retreat in their net profits in 2009 compared to 2008, with Burqan bank registered 83.2% decline in profit. Kuwait International Bank (KIB) and Boubyan posted losses of KWD 8.2m and KWD 51.6m respectively in 2009, whereas Gulf Bank reduced its losses from KWD 359.5m to KWD28m largely assisted by the improvement in operational profits. This big difference in the Gulf bank's net losses is being the main cushion behind the hike in the sector's profits.

Low deposit growth reflection of liquidity concerns

Total assets of the banking sector advanced at a slower pace of 2.4%, well below last year's double digit growth to register KWD 43.96bn as of the year ending 2009. The bank's strategy of cautious loan growth due to rising loan defaults and the decline in the value of investment securities amid the instable equity markets, were the main driving factors. Moreover the economic crisis hindered banks' deposit growth amid the liquidity bubble in the market. Also funding profile weakened in 2009 because of an increased reliance on noncore customer deposits. Overall liquidity in the banking system seems to be at comfortable levels.

Cautious loan growth

Loan growth slowed considerably in the year 2009 as Kuwaiti banks adopted a cautious approach to lending. Compared to double-digit growth rates achieved over recent years, net credit growth witnessed a 6.7% increase in 2009 despite strong Central Bank of Kuwait (CBK) interest rate cuts during 2008 and 2009. Credit facilities are still held back by the ongoing slowdown in economic activity. Kuwait banks' loan portfolio continues to be skewed towards real estate, construction and personal lending. These sectors are more prone to economic crisis and are very volatile in nature as experienced during the economic crisis.

Asset quality deteriorates; Weak reserve coverage

Kuwait banks witnessed a significant increase in Non-performing loans and provisions required to cover such loans. The banking sector as a whole reported an increase of 84% in the absolute NPLs for the year 2009, and despite a 39% increase in provisions, the reserve coverage declined to 68% from 90% in 2008. The coverage ratio remains poor when compared to global peers. Moreover there is a significant gap between Kuwaiti banks. Banks like NBK, Al-Ahli and Boubyan have coverage of more than 100%, where as banks like Gulf bank, KFH, KIB, and Burgan are below the Industry average. As for Kuwait, while aggregate figures reveal a 3.5% decline in provisioning charge during 2009, a truer picture of a 58.2% increase in provisioning charge is obtained after excluding the distortion created by Gulf Bank. Gulf Bank took heavy provisions during 2008 amounting to KD334mn as against KD111mn in 2009, hence distorting the aggregate for the sector. The fallout from the global economic crisis took longer to hit Middle East banks, and only really began to hurt profits in late 2008. But in 2009, the full effects of the global crisis took their toll on the region's banks.

Capitalization- strength for Kuwaiti banks

Kuwaiti banks benefit from a strong capital base which is relatively higher above the minimum capital adequacy ratio set at 12%. Most Kuwait banks have recapitalized in 2008 and 2009 to mitigate the risk of rising provision and impairment expenses. The recapitalization process by some banks strengthened shareholders' equity to KWD5.0bn compared to KWD4.5bn in 2008, growing by around 11.5%. Gulf bank suffered equity erosion in 2008 on account of its derivative losses and had to be recapitalized with adequate support from the government. Burgan Bank has received the approval of CBK and shareholders' to increase its paid-in capital by KWD36mn from KWD104.1mn to KWD140.1mn, while Boubyan bank is planning a 50% capital increase rights' issue which NBK is expected to subscribe. Solvency levels of the banks continued to remain strong except for Gulf bank wherein the NPLs are still high, even after the recapitalization.

Conclusion

In the long run, Kuwaiti banks are expected to benefit from favorable demographics, rising oil revenues, government investments and low banking penetration levels and most importantly to a new 37 billion economical development plan. However, in the current scenario the banks' performance continues to be constrained by weak credit growth, high NPLs, and pressure on liquidity. Most banks have been impacted by exposure to the Kuwaiti investment sector and exposure to Saudi groups Saad and Al-Gossaibi, which has forced banks to increase provisions and strengthen capitalization. The exposure to the troubled investment sector, and high-profile regional companies which have been restructuring debts, has weighed heavily on profits in the banking sector. Capitalization and pre-provisions earning generation capacity will remain stable, offering cushion against the expected continuation of asset quality deterioration.

Appendix

Key financial information of the Kuwait banks for FY2009

	NBK	CBK	GBK	ABK	BURG	ALMUTHAHED	KFIN	BOUBYAN	KIB
Size and Scale (KWD mn)									
Market Cap (as of 1st April 2010)	3,860	1,196	915	548	385	590	2,838	927	228
Operating Income	500	127	131	105	151	69	767	18	46
	2.9%	*(25.8%)*	*650.6%*	*28.6%*	*36.3%*	*(34.1%)*	*(8.6%)*	*(67.2%)*	*(49.6%)*
Net Profit	265	0	(28)	39	6	14	119	(52)	(8)
	3.9%	*(99.9%)*	*(92.2%)*	*(15.0%)*	*(83.2%)*	*(72.3%)*	*(24.3%)*	*(2,966.7%)*	*(141.4%)*
Total Assets	12,907	3,595	4,744	2,966	4,094	2,261	11,291	965	1,140
	7.8%	*(16.5%)*	*(4.1%)*	*(2.3%)*	*3.8%*	*1.1%*	*7.1%*	*14.8%*	*5.3%*
Total Equity	1,825	440	408	330	325	213	1,216	87	173
	17.2%	*(11.4%)*	*976.0 %*	*5.8%*	*4.9%*	*(12.3%)*	*(2.3%)*	*(35.5%)*	*5.1%*
Customer Deposits	6,600	2,042	3,149	1,838	2,425	1,460	7,262	709	713
	19.0%	*(22.8%)*	*(17.7%)*	*(7.7%)*	*0.4%*	*1.9%*	*9.8%*	*24.5%*	*12.1%*
Gross Loans*	8,113	2,772	3,770	2,171	2,364	1,648	6,809	683	909
	12.5%	*1.9%*	*(1.8%)*	*(3.3%)*	*7.7%*	*7.6%*	*7.6%*	*302.9%*	*18.0%*
Net Loan	7,817	2,454	3,248	2,024	2,247	1,561	6,407	619	873
	12.4%	*(2.4%)*	*(6.7%)*	*(5.0%)*	*5.3%*	*6.0%*	*6.8%*	*326.3%*	*16.8%*
NPLs	143	462	1,149	130	237	81	642	17	78
	1.6%	*236.1%*	*138.1%*	*134.2%*	*663.2%*	*73.7%*	*(0.0%)*	*180.3%*	*45.4%*
Provisions	296	318	522	147	117	87	402	64	36
	15.5%	*55.9 %*	*45.5%*	*26.4%*	*89.9%*	*46.6%*	*23.1%*	*163.4%*	*54.3%*

* *Gross Loans from Islamic Banks is called Total Financing & Investing Activities*

ALMUTHAHED—previously BKME

Source: Zawya, Company reports, CSR

Ratios for the year 2009

Capital Adequacy (%)									
	NBK	CBK	GBK	ABK	BURG	ALMUTHAHED	KFIN	BOUBYAN	KIB
Total Capital Adequacy	15.00	18.22	15.90	15.55	16.90	16.81	15.21	13.84	NA
Tier 1 CAR	14.50	NA	11.50	17.23	12.09	15.26	15.08	13.56	19.70
Dividend Payout	44.17	-	-	44.15	-	-	47.88	-	-
Asset Quality (%)									
Provision/NPL (x)	2.08	0.69	0.45	1.13	0.49	1.07	0.63	3.74	0.47
NPLs / Total Loans	1.76	16.67	30.47	6.00	10.01	4.92	9.43	2.50	8.52
Net NPL's / Total Equity	(8.42)	32.83	153.78	(5.12)	36.75	(2.82)	19.73	(53.85)	23.90
Total Investments / Total Assets	0.14	0.16	0.19	0.15	0.14	0.13	0.6	0.71	0.8
Net Loans / Customer Deposits (x)	0.72	0.80	0.79	0.78	0.66	0.79	0.85	0.94	1.17
Earnings Quality/Profitability (%)									
Net Spread	4.62	3.53	2.53	3.18	4.37	3.46	NA	NA	NA
NII / Total Operating Income	75.32	82.07	68.60	77.89	67.32	83.60	NA	NA	NA
Operating Margin	42.22	0.08	(11.23)	26.11	11.24	8.49	35.14	(156.86)	27.65
Operating Cost / Operating Income (x)	0.36	0.21	0.36	0.29	0.29	0.40	0.38	1.07	0.36
Return on Assets	2.05	-	(0.59)	1.32	0.15	0.63	1.05	(5.36)	(0.72)
Return on Equity	14.53	0.03	(6.88)	11.85	1.91	6.69	9.77	(59.33)	(4.75)

Source: Zawya, Company reports, CSR

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