CAPITAL STANDARDS
AN INDEPENDENT RATING AGENCY

Kuwait

Report Contents

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Summary

The year 2009 has been a challenging year for many markets in the world. The stabilizing crude prices during the second half of 2009 acted as a hedge for oil rich countries like Kuwait. However, budgets and projects have been approved in the first half of 2009, and this explains the large amount of cancelled or put on hold by GCC countries (totaling to USD 2.2 trillion).

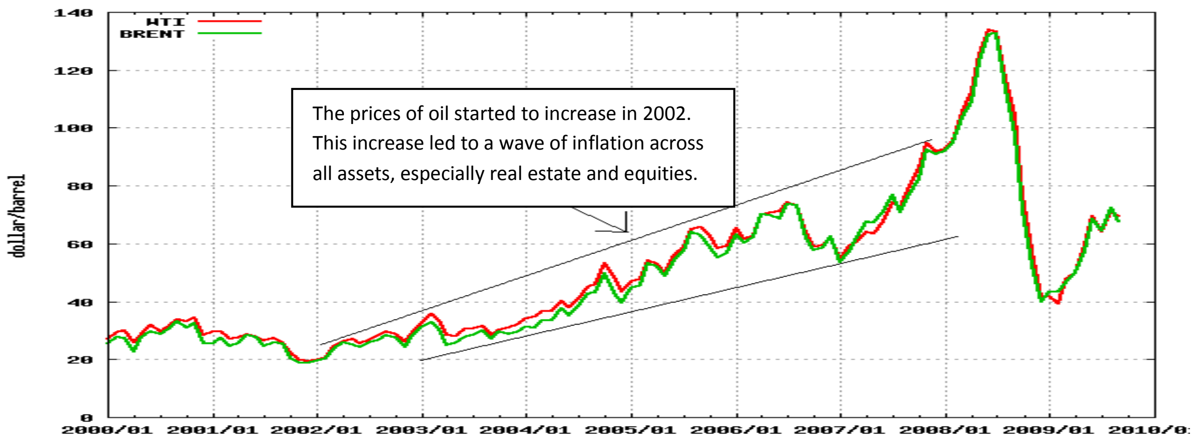
Kuwait Stock Exchange lost 60% of its total value from Q2-2008 to Q4-2008. This resulted in huge losses for companies that had large portions of their profits derived from securities dealings, in fact some of them became on the verge of bankruptcy. The market continued to decline in Q1-2009 followed by an increase in Q2 and Q32009 which was led by opportunities rising from significant decline in values of many attractive stocks for investors. However, the profits of listed companies in KSE did not show any significant improvement where the investment and real estate sector continued to record very poor performance when compared to same periods of FY2008. For the nine months ended in 30/09/2009, the average decline in total profits (of the listed companies who released their results) was 56% compared to the nine months ended in 30/09/2008.

The Central Bank of Kuwait intervened to support and to enhance the confidence level in the banking system in Q4-2008 by guaranteeing all local banks' deposits and cutting the discount rate to 3% in May 2009. A financial stimulus package was approved by the government to provide support for companies who are having financial difficulties. Along with other important events, the market closed 2009 with a slight improvement and a cautious optimism and anticipation to what 2010 has to unfold.

The GCC Economy

The world has been through a tough economic crisis that evaporated billions of dollars of economic value. One of the major effects the crisis had was on the prices of crude oil which is considered the major source of income for the GCC. The significant increasing trend in oil prices that started in 2002 fueled asset price inflation to levels which are considered abnormal. After the financial crisis, these all-time highs suddenly collapsed.

Oil Prices



The problem surfaced during the second half of FY2008, pressuring GCC countries' exchanges to decline. With the fear of more downward pressure, banks tightened their lending policies on the expectations that many borrowers will face financial difficulties. Moreover, price of crude oil dropped significantly in Q42008 to below USD 40 per barrel after the all-time highs of above USD 140. This acted as a negative force on the economic activities in the GCC region where many major construction and development projects were cancelled or put on hold.

Value of Real Estate & Construction Projects in the GCC Region

Country	Value in Nov-08 USD bn	Value in Nov-09 USD bn	% Change	On-Hold Projects in Nov-09 USD bn
Kuwait	298.8	271.5	(9.1%)	41.04
Bahrain	57.7	68.3	18.3%	9.1
Saudi Arabia	606.5	609.4	0.5%	39.2
Oman	106.4	104.6	(1.7%)	6.7
Qatar	216.9	204.8	(5.6%)	7.9
UAE	1,228.2	915.9	(25.4%)	368.2
GCC Total	2514.5	2,174.5	(13.5%)	472.1

Source: Istockanalyst

The value of projects in the GCC has declined by 13.5% from Nov-08 to Nov-09 and this was mainly due to the large amount of projects that were put on hold. The biggest contributor to the On-Hold Projects (OHP) is the UAE with a 78% of total OHPs. This could be explained by the default of some Government Related Entities (GREs) in Dubai; Dubai World and Nakheel.

The liquidity crunch in the GCC was mainly due to the decline in oil prices which meant thinner surpluses for the Council's countries; therefore less money is available to spend on mega projects. Another reason for the liquidity crunch is attributed to the high debt exposure by large corporations in the region. Some of those corporations were affected by Dubai corporate default which blocked their way to expand and made them focus more on debt service. Foreign investor's confidence also declined after the recent crisis in Dubai which may, again, fuel the liquidity crisis. After the stabilization of the oil prices at a range of USD 70-80 per barrel, the GCC countries are implementing different strategies to support their economies.

Kuwait

Overview

KWD bn	2002	2003	2004	2005	2006	2007	2008
GDP at market prices	11.6	14.3	17.5	23.6	29.5	31.8	NA
Oil Revenues	5.5	6.2	8.2	13.0	14.5	17.7	NA
GDP growth rate	8.3%	23.1%	22.8%	34.7%	25.0%	8.0%	NA
Money Supply M2	9.6	10.4	11.7	13.1	15.9	19.0	22.0
% Change YoY	4.8%	7.8%	12.1%	12.3%	21.7%	19.3%	15.6%
Inflation (FY2000-100)	102.2	103.2	104.5	108.8	112.1	118.3	129.3
% Change YoY	0.9%	1.0%	1.3%	4.1%	3.0%	5.5%	10.6%
CBK Discount Rate %	3.25%	3.25%	4.75%	6.00%	6.25%	6.25%	3.75%

Source: Central Bank of Kuwait, OPEC

Kuwait is an oil producing country with its GDP mainly comprised of income from oil. Over the last seven years, oil prices started to rise and Kuwait, along with other GCC countries, started to build up huge amounts of reserves from oil revenues. The county's GDP witnessed an average annual growth of 20.3% (2002-2007) and this is reflected by the trend of crude prices. The yearly increase in money supply was stable from 2002-2004, then it increased thereafter. This lead to an inflationary increase in money supply M2as we saw inflation picking up in 2005-2008. Moreover, the Central Bank of Kuwait increased the discount rate to stabilize and control the strong economic growth which is mainly driven by the increase in oil prices. However, the decline in asset prices and the shortage of liquidity led to a decline in prices of food and rent (main drivers of inflation) thereby inflation dropped to 6.8% YoY in H12009.

CBK's intervention comes out of fear from entering into a deflationary period which could have more severe effects. A deflationary period affects firms by eroding profits which could lead them to dismiss labor, thereby increasing unemployment rate. Another affect of a deflationary period is on investor confidence; if investors think that prices will decline more, they will not invest their excess funds, but save it instead.

Credit Ratings

The importance of Credit Rating became clear after the effects of the financial crisis surfaced. Credit risk becomes the most important factor when banks lend money in a difficult environment. Credit Rating Agencies (CRAs) play an important role which helps the regulatory bodies in monitoring the markets and assuring an efficient flow of sufficient information which is not biased. If the regulatory bodies in Kuwait and the region have enforced independent credit ratings on listed/public firms, investors would have more been better informed about the credit quality of those firms. In addition they would have a professional additional tool for their investment decisions. This tool will signal to investors and shareholders the probability of default by those firms.

CRAs simply provide related parties; investors, regulators, stakeholders, researchers with sufficient information on the risk inherent in the market, thereby assisting the related parties in making decisions which are based on independent and reliable sources of information. In an environment where the level of transparency and public disclosure is low, a CRA is needed the most to balance the flow of information i.e. eliminate the concentration of information between a small number of market participants, to increase market risk management practices, provide strong early warning sign in case of default, indicate the probability of default & corporate financial reporting and reliability.

Moody's (M), Standard & Poor's (S&P) and Capital Intelligence (CI) Ratings	
Companies	
Global Investment House (S&P)	The company was downgraded from D/D to SD/SD which was followed by a withdraw request by Global
Investment Dar (CI)	The company was downgraded from D to SD after a default on a USD 100 mn Sukuk payment
KIPCO (M)	Moody's affirmed the Baa1 long term, but change the outlook from stable to negative, reflecting deterioration in the credit quality of some of its core subsidiaries (Date:4th of Sep 2009)
Gulf Investment Corporation (M)	Moody's affirms Gulf Investment Corporation's Baa2/P-2ratings; downgrades BFSR to D-(Date:24th Nov 2009)
Shuaa Capital psc (M)	Moody's upgrades Shuaa Capital to Ba2; stable outlook
Kuwait Investment Co. (M)	Moody's Assigns Baa3 issuer rating to Kuwait Investment Co.(22nd July 2009)
Banks	
BKME (M)	Moody's downgraded BKME's rating from C- to A3/D+ with negative outlook, reflecting Moody's expectation that pressure on asset quality and credit charges will persist, particularly in view of the time lag between negative market events and observable evidence of rising non-performing loans.(8th of Sep 2009)
ABK (M)	Moody's downgraded ABK's rating from C- to D+ with negative outlook,
CBK (M)	Moody's downgraded CBK's rating to A1/C- with negative outlook(Date:7th of Sep 2009)
NBK (M)	Moody's affirms NBK's rating Aa2/P1; downgrades BFSR to C+
Gulf Bank (M)	Moody's downgrades Gulf Bank to A3/D+; ratings on review for possible downgrade
Burgan Bank (M)	Moody's downgrades Burgan Bank to A2/D+; negative outlook
KFH (M)	Moody's affirmed KFH's long term rating Aa3/P-1, BFSR: C- with stable outlook

There have been five downgrades amongst Kuwaiti banks by Moody's; BKME, ABK, CBK, Gulf Bank and Burgan Bank. These downgrades indicate deterioration in the financial strength of those banks which was primarily attributed to the financial crisis. Banks operates in a highly regulated environment and are considered the backbone for any economy. Banks are linked to the economies they operate in and they reflect the performance of those economies. Therefore the downgrade of those banks, not only reflects the deterioration of their financial strength, but also reflects the difficulties the Kuwaiti economy is facing.

Kuwait Stock Exchange

Overview

The Kuwait Stock Exchange (KSE) has slightly recovered in FY-2009 over considerable losses incurred in FY-2008. These losses have been reflected in the movement of market capitalization during each quarter. The market had already lost around 52.17% of its market capitalization by the end of FY-2008. However KSE slightly improved in Q1-2009 and remained stable in the following two quarters. In comparison with FY-2008, KSE's total market capitalization is 13.32% lower than the value back then, which amounted to KWD 32.90 bn.

Market Capitalization

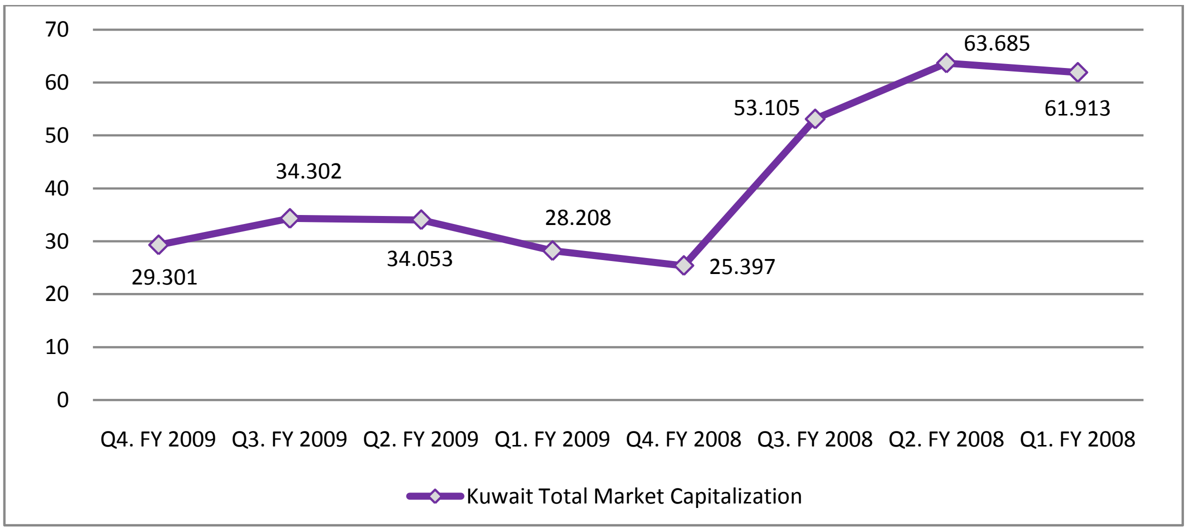
Market Capitalization of KSE in FY 2009

	%Change (Dec 2008-Dec 2009)	Q4. FY 2009	Q3. FY 2009	Q2. FY 2009	Q1. FY 2009	Q4. FY 2008	Q3. FY 2008	Q2. FY 2008	Q1. FY 2008
Banking	(10.11)	10.14	11.36	11.27	10.14	11.28	15.97	18.45	19.4
Investment	(25.18)	3.18	3.72	3.89	3.11	4.25	8.95	11.33	11.15
Insurance	(20.14)	0.34	0.34	0.36	0.31	0.43	0.49	0.52	0.51
Real Estate	(21.64)	1.81	2.09	2.38	1.68	2.31	4.39	6.31	4.14
Industry	(1.55)	2.54	2.99	2.84	2.18	2.58	4.86	6.21	5.6
Services	NA	7.94	9.97	9.85	6.77	NA	11.72	13.46	13.65
Food & Beverage	21.31	0.74	0.9	0.75	0.64	0.61	0.97	1.15	1.22
Non-Kuwaiti companies	(33.76)	2.61	2.93	2.71	3.38	3.94	5.76	6.26	6.24
Total	(13.32)	29.30	34.30	34.05	28.21	33.20	53.11	63.69	61.91

Market capitalization began to rise again after the first quarter of 2009, improving the market by 20.72% in the second quarter to reach KWD 34.05 bn. The oil prices started rising again during the month of August, while trading activities declined as holy month of Ramadan began, hence resulted in quite resilience market capitalization at the end of the period with minimal increase of 0.73%. In comparison with peers in the GCC region, KSE's market capitalization declined the most.

In Q4-2009, the contribution of the Banking sector to the total market capitalization was the highest, constituting 34.60%. Services sector is the second major contributor, comprising 27.09% of the total market capitalization. As a result of the financial crisis, the share prices of most companies in the market declined, forcing many sectors to witness dramatic declines in market capitalization. The investment sector shed 64.5% of its market cap (Q3-2008-Q4-2009). The Real Estate Sector's market cap declined significantly by 59% for the same period. These significant declines in value, reflects the investors' confidence in the market which was really vulnerable at that time. The overall market capitalization witnessed a declining trend since Q2-2008 until it was supported in Q-12009.

Trend of Kuwait Market Capitalization (Values are in KWD bn)



Quarterly Performance

Sector	2008 Annual KWD bn			Q1 KWD bn			H1 KWD bn			Q3 KWD bn		
	2007	2008	% Change	2008	2009	% Change	2008	2009	% Change	2008	2009	% Change
Banking	1.04	0.31	(70%)	0.29	0.13	(56%)	0.63	0.22	(65%)	0.89	0.33	(63%)
Investment	1.16	(0.40)	(135%)	0.24	(0.21)	(190%)	0.46	(0.23)	(149%)	0.53	(0.32)	(161%)
Insurance	0.09	0.001	(98%)	0.02	0.0003	(99%)	0.04	0.006	(82%)	0.04	0.009	(75%)
Real Estate	0.35	(0.05)	(115%)	0.12	0.02	(80%)	0.24	0.06	(76%)	0.25	0.05	(79%)
Industry	0.45	(0.38)	(184%)	0.13	(0.04)	(132%)	0.23	0.03	(86%)	0.20	0.07	(66%)
Services	0.72	0.47	(35%)	0.19	0.14	(27%)	0.43	0.35	(18%)	0.55	0.45	(18%)
Food & Beverage	0.08	0.03	(60%)	0.02	0.007	(60%)	0.04	0.02	(54%)	0.003	0.007	108%
Non-Kuwaiti	0.49	0.38	(23%)	0.11	0.07	(34%)	0.31	0.13	(59%)	0.44	0.14	(67%)
OTC	0.01	0.006	(50%)	0.003	0.0001	(96%)	0.009	0.001	(88%)	0.016	0.003	(80%)
Total	4.38	0.37	(91.6%)	1.12	0.12	(89.6%)	2.39	0.59	(75.3%)	2.92	0.74	(74.8%)

Source: Al Juman Center

FY2008

The financial crisis started in Q42008 and was significantly reflected in the performance of the KSE listed firms for FY-2008. In Q4-2008, Gulf Bank had a large open derivative position on its accounts which almost forced the bank into bankruptcy. The Central Bank intervened by issuing Law No. 30/2008 concerning the guarantee of all local bank deposits and it came into effect on 3/11/2008. CBK also decided to cut the discount rate by 50 basis points from 4.25% to 3.75% on 17/12/2008.

FY-2008 ended on huge losses resulted from significant declines in asset prices, mainly real estate and equities. The listed firms on KSE ended the year with a 91.6% decline in total profits (all listed firms except a few for not releasing their results) with the Industrial, Investment and Real Estate sectors getting the worst out of it where their profits declined by 184%, 135% and 115% respectively.

Q1-2009

After the results of FY-2008, which led to a decline in the total market cap by 52% (Q3-2008 to Q4-2008), the market responded by supporting the prices and the market cap increased in Q1-2009 (by 11%). Many listed firms have a significant portion of their assets in listed and unlisted equities, which were severely affected by the crisis, and this was reflected in the quarterly results of Q1-2009. The investment sector recorded huge losses of KWD 210 mn in the first quarter, followed by a KWD 40 mn loss in the industrial sector which has many holding companies that hold ample amounts of equities. In Q1-2009, the total profit for the listed firms declined by 89.6% (when compared to Q1-2008) from KWD 1,120 mn to KWD 120 mn.

The banks showed a conservative lending policy because of restrictions by the central bank and after what happened in Q4-2008 which fueled the problem by not providing liquidity to the market. The increase in total lending by banks witnessed a minimal increase over the first quarter (average of 0.73% when compared to Q42008) and this was out of caution, anticipation and fear of ‘what if things get worse’.

Moreover, this quarter witnessed an some instability in the political arena where the Emir of the State of Kuwait dissolved the Parliament. This fueled the atmosphere with uncertainty, where banks slowed their lending activities, investors held back their capital, and speculation dominated the market. Furthermore, the Economic Stimulus Package was approved by the government and this helped the market index from declining below the 6000 points support.

Q2-2009

In the second quarter of 2009, the first positive indicator was the increase in prices of crude oil which reached USD 68 per barrel. This had a positive effect on the market which led to breaking the resistance levels of 8000 points. The Central Bank also encouraged banks to lend cheaper money to financially sound investors by cutting the discount rate by 25 basis points from 3.75% to 3.50%.

In Q2-2009, the market movement and the performance of the companies was still unclear for many investors until the quarterly results were released. All the sectors recorded profits except for the investment sector, which added KWD 20 mn to its already KWD 210 mn loss from Q1-2009. The decline in total profits of the markets, from Q2-2008 to Q2-2009 slightly contracted (75.3%) when compare to the decline from Q1-2008 to Q1-2009 (89.6%). This indicator shows that the market performance is improving; however, it could take an extended period of time to be reflected on the market place.

Q3-2009

In this period, the price of crude oil stabilized above USD 65 per barrel which gave investors a positive indicator that the state budget could witness an adequate surplus. However, after the release of Q22009 results, the market reacted negatively by declining from above 8000 points in Q22009 and close at above 7,800 points. This, along with the modest increase in the total market profit of KWD 15 mn which did not match many investor expectations, applied some negative pressure on the market.

The news on the sale of the Kuwaiti Telecommunications Company 'Zain' and the collecting of the shares by National Investment Company pulled a large amount of liquidity from the market by freezing those shares. This quarter witnessed volatile trading, then declined at the end of the period when the speculative activities declined after Zain's sale news.

Q4-2009

The last quarter of 2009 witnessed a declining trend in the first two months (11.3% decline when compared to the close of Q32009) then stabilized in December to close at 7,005 points (1% increase from November). However this period included many significant factors that are expected to directly and indirectly affect the performance of 2010. A significant effect on the market index was the news on putting Zain's sales transaction on hold and the American Department of Defense's law suit against the Kuwaiti logistics firm, Agility which affected the index negatively.

Additionally, during this quarter, some Government Related Entities in Dubai (Dubai World and Nakheel), defaulted on some USD 100 bn debt facilities. This happened when the two companies announced their intentions to stop servicing their debt and demanded a six-month reschedule plan. However, this did not have a great effect on the Kuwaiti market.

Towards the end of the quarter, some positive events took place which led the market index to rebound from 6,934 points. Among these events, Abu Dhabi's USD 10 bn support to Dubai World and Nakheel, Kuwait Investment Authority's profit from the sale of its shares in Citi Group which resulted in a 36.7% return on investment (a profit of USD 1.1 bn), the approval of the Gulf Currency Union by the GCC leaders in the Council's 30th summit and Global Investment House's rescheduling of their USD 1.7 bn in debt. All of these events helped the market index to stabilize and gave an indicator on the possibility of the market recovery in 2010/2011.

Market Indices

KSE market Indices in FY 2009

	December	November	October	Q3	Q2	Q1
KSE price index	7,055.70	6,933.70	7,347.50	7,817.30	8,080.30	6,745.30
KSE weighted index	387.4	387.02	422.78	454.97	448.9	358.26

The volatility of the weighted index was more than the price index during the Q4-2009. The market deterioration in the month of October continued until the third week of November. In November, the price index closed at 6,993.70 recording 5.63% monthly decline, while weighted index ended at 387.02 points recording an 8.46% loss, however KSE's performance reversed in the last week of November. In 24th of December the market closed at 7,055.70 points, 1.75% increase in comparison with the market index in November.

Sector Indices

All sectors ended the third week of December in the green zone except for the industrial sector which declined at a rate of 0.04% from November to December. In 24th of December, real estate sector achieved the highest growth of 3.37%. The Dubai crisis did not noticeably affect the real estate sector, since real estate companies and financial institutions clarified that their exposure to Dubai World and Nakheel is minimal.

Sectors Price index in FY 2009

	% Change (November-December)	December	November	October	Q3	Q2	Q1
Bank	2.15	8,485.4	8,307.10	8,822.50	9,135.90	9,252.50	8,298.10
Investment	2.75	5,788.5	5,633.80	5,867.20	6,568.00	7,087.50	5,997.10
Insurance	0.57	2,743.5	2,728.00	2,790.30	2,875.00	2,972.80	2,518.20
Real Estate	3.37	2,840.1	2,747.60	2,884.40	3,094.60	3,415.60	2,768.50
Industrial	(0.04)	5,335.00	5,336.90	5,936.50	6,266.00	5,884.90	4,693.80
Services	3.42	14,924.40	14,431.30	15,064.90	15,972.00	16,307.00	13,449.00
Food	1.96	4,240.90	4,159.30	4,658.70	4,815.00	4,692.10	3,676.60

Trading Activity

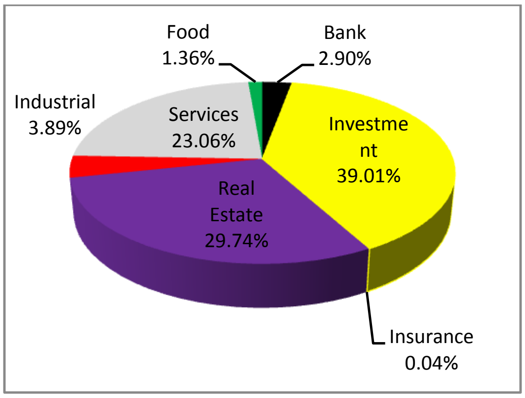
Market Trading Indicators

	December	November	October	Q3	Q2	Q1
Volume traded (Shares mn)	7,767.74	5,228.81	5,538.73	22,580.83	49,147.69	15,934.22
Value traded(KWD mn)	1,058.33	888.69	1,112.87	5,843.33	9,674.35	3,151.65

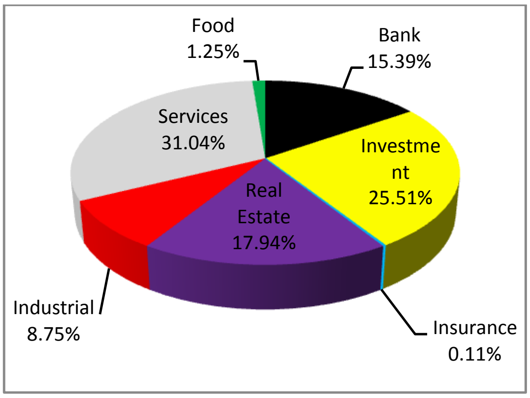
The trading indicators (value and volume) witnessed a declining trend since the second quarter of 2009. In November 2009, the trading activity reached its lowest, compared to October and December of 2009, with volume totaling to 5.2

bn shares and value to KWD 0.9 bn. After that, the activity picked up in the last month of Q42009 as investors anticipated some relief in 2010.

Volume allocated by sector in Dec 2009



Value Allocated by Sector in Dec 2009



The investment sector had the highest trading volume with 7,184.01 mn of shares, which represent 39.01% of the total volume traded during the month of December. Real estate was the second highest traded sector with trading volume of 5,435.20 mn of shares, reflects 29.74% of the total traded volume. Moreover, the service sector had the highest trading value of KWD 312.69 mn during the month of December. The investment sector had the second highest trading value of KWD 256.95 mn, constituting 25.51% of the total market value.

During the month of November, the governor of the Central Bank of Kuwait (CBK), Sheikh Salem AbdulAziz Al Sabah encouraged banks to provide finance to investment companies. Following that, GIH announced in December that their debt restructuring plan succeeded. In addition, Aayan Leasing & Investment Company recently announced that it has received approval from local bank to help the company refinancing its debt. These events could enforce, to some extent, investors' confidence. As a result, the trading volume and the value traded over investment sector noticeably increased by 22.37% and 20.54% respectively in December 2009.

As for banking sector it witnessed significant reduction in volume and value in December as compared to November. This could be due to the investors' increasing risk appetite which shifted their attention towards other riskier companies (riskier than banks) that provide higher returns. Another possible reason could be the unclear position of banks, where the disclosure on the banks' lending portfolios is very minimal.

The Service sector also witnessed a noticeable increase of 50.08% in its trading volume and this was driven by the unsubstantiated news on the sale of Zain. Another reason for the increase in the trading value and volume of this sector is the news on the law suit on Agility which significantly increased the trading activity on the stock.

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