

Kuwaiti Holding Companies

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Industry Overview

An investment holding company is defined as either a public or a private group holding entity ("Group Holding Co.") that acts as a financial investor. It holds a diversified portfolio mainly consisting of stakes in private or publicly traded equity participations. Ancillary investments in other risky non-equity securities might exist but are generally insignificant. Such companies often have a history of being majority-owned by a specific family. In preparing this report, Capital Standards depended on interim results of the nine-month period ending in Sep 30th 2009 and compared it with years 2007 & 2008.

The tables included in the appendix, show major financial highlights of the holding companies that were able to have positive profit during 2009.

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Financial Overview

- Among the 35 listed holding companies in Kuwait, 14 have recorded net profit in the nine-month period ending in Sep 30th, 2009.
- Because of the business model of holding companies, which concentrates on investing in equities, this sector was negatively affected by the financial crisis. (Total revenue 1,498.166 KD million 2007 to 652.457 KD million 2009 -56%), (Profit 810.131 KD million 2007 to 74.763 KD million 2009 -90%)
- There are 35 listed holding companies in Kuwait; 11 listed in the investment sector, 7 listed in the real estate, 14 in the services sector, and 3 listed in the industrial sector.
- Among the 11 investment firms, none are registered with the Central Bank as investment houses.
- The business model of a holding company is very close to the structure of a managed portfolio or fund.
- Among the most important factors that holding companies should concentrate on is to attain stronger financial position after the financial crisis; lower risk investment portfolio, better quality of assets, higher asset diversification, effective management of liquidity, concentration on listed higher dividend producing subsidiaries, and lower short-term debt structure.

- The majority of listed holding companies suffered from lower portfolio valuation, increasing asset leverage ratios, higher short-term debt and lower cash coverage during the nine month period ending in Sep. 2009, compared to the year 2007 (before the crisis' period).
- Debt maturity profile of holding companies is geared towards short-term and bilateral credit lines. (Short-term to total debt ratio for eight of the holding companies included in the sample was above 80% during year 2009).
- The year 2008 was the worst year for holding companies (average profit for the sample companies' -298.246 million).
- Holding companies performance has a strong correlation with both KSE & BSE market indices.
- On average, holding companies have low level of transparency consistent with the local market model.

Legal definition of holding companies

The objective of holding companies, according to articles 226-229 of the Commercial Companies Law No. 15 - 1960, is to own stocks and shares in Kuwaiti or non-Kuwaiti companies, participate in establishing companies, lending and managing companies in addition to acting as guarantor for these companies. To have the legal status of acting as a holding company and to have the right to lend it, a holding company should own a minimum of 20% of the capital of borrowed entity.

Holding Companies Correlation with the Market

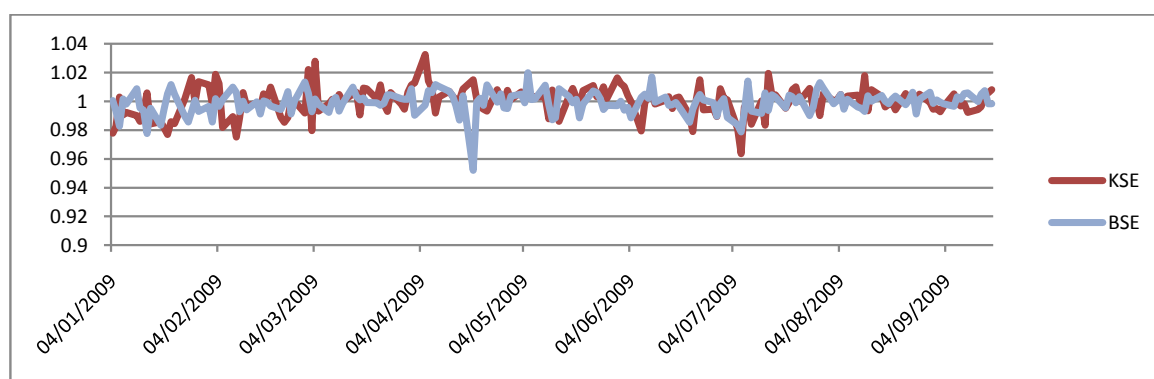
As a result of the global financial crisis, last year was a tough period for all market participants. Holding companies are not an exception as they were among the first companies to be affected due to their high exposure to equity's prices volatility. They suffered from large-scale loss in the prices of their assets; hence, they have reached weaker portfolio values.

Holding companies are the most correlated companies with the stock market due to the nature of their business model. Their investment portfolio depends on the majority and minority ownership stakes in companies listed on the stock market.

Indices Volatility in KSE and BSE

Kuwaiti holding companies not only invested heavily in Kuwait Stock Exchange, but were also engaged in investment activities in Bahrain Stock Exchange. Figure 1 shows that Bahrain Stock Exchange movement is highly correlated with KSE index movement. Therefore, it is important to observe market movements of both KSE and BSE in order to understand the impact on the Kuwaiti Holding Companies.

Figure 1: Movement in KSE and BSE from 1-Jan to 30-Sep 2009



Holding companies overview

Among the 35 listed holding companies, 11 are listed in the investment sector, 14 are listed in the services sector, 7 are listed in the real estate sector, and 3 are listed in the industrial sector. Holding companies' main function is to have long-term investment in wide distribution of assets to minimize risk, with some of them focusing on one or two industries. According to the current effective laws holding companies listed in the investment sector are not required to be registered with the Central Bank of Kuwait. This leaves room to escape the oversight of the Central Bank on the sector. It is also noted that some holding companies that are listed in the industrial and services sectors focus their investment activities in other sectors, mainly the financial sector.

In this report, we focused on Holding Co's that recorded positive profit at the end of the nine-month period of 2009. The Table, included in the Appendix, shows the basic financial indicators of this list and will display changes in major ratios before and after the financial crisis.

Analytical Consideration of Holding companies

Introduction

Capital Standards has identified three key rating factors for the analysis of holding companies:

- Asset concentrations, portfolio volatility, geographic diversification, and sector segmentation.
- Corporate governance framework which compromise of dividend policy, shareholder protection, and transparency structural complexity.
- Financial strength which compromise of market value to debt, financial inflows to interest, dividend control and liquidity position.

However, in preparing this report, some of the above key factors were hard to be identified due to lack of transparency standards in the local market. Nevertheless, we used all public information available about the listed holding companies included in this report. Among all listed holding companies in Kuwait, KIPCO and NIG are the only holding companies that are rated by credit rating agencies, and because of that have a relatively higher level of transparency.

Holding companies witnessed a dramatic deterioration in their assets values due to the financial crisis that started back in 2007. Moreover, foreign and local financial institutions blocked liquidity channels on companies and at the same time required full payment of any maturing debt—mostly short term obligations. Therefore, to cover immediate needs of liquidity; holding companies started to sell off some of their financial assets which further deteriorate their values.

Financial Performance

Over the three-year period KIPCO was the best performer compared to all other holding companies. Net income peaked to KD 884.681 million and KD 367.918 million in 2007 & 2009, respectively. The ROE was 53.10% in 2007 for KIPCO, 27.69% Human Soft, 24.74% MAZAYA, and 18.52% National Industries. Comparing the results with 2009 it is noted that performance was significantly affected by the crisis (5.14%, 1.93%, 5.79%, and 0.07% for the same companies). In general, the year 2009's performance was significantly better than 2008; this can be explained by improved expectations for the next period, and can be attributed to management decisions and restructuring strategies such as sell offs of unprofitable subsidiaries. The tables show the same pattern for ROA ratios between the two periods before and after

the crisis. The drop between the two periods is mainly attributed to the deterioration in the value of the financial assets of these companies coupled by increases in the pressure on how qualified those assets are to be used as collaterals against debt. In addition, it is hard to liquidate the asset portfolio of holding companies due to the nature of their composition that is dominated by the availability for sale securities, whose value has declined significantly, and, in some cases, below the cost value.

Assets diversification helps minimizing losses

Another factor that contributes to a stronger financial position during recession periods is asset diversification. Again, the majority of holding companies included in this report (with positive Net Income) who maintained a relatively positive performance during the financial crisis had an asset portfolio that is characterized by higher concentration and diversification. KIPCO, who has the highest profit among holding companies, also happens to have assets that cover the largest geographical area starting from Kuwait, GCC, MENA, USA, and UK.

As for MENA holding company, its positive performance was mainly attributed to focusing on investing in the real estate sector in Egypt. According to the Central Bank of Egypt the real estate sector witnessed a growth rate of 3.6% during the financial crisis period.

Dividend Cash Flow & Asset Leverage

The business model of holding companies depends on cash inflow and dividend from well diversified investment portfolios that cover the financial services sector, industrial sector, transportation sector, and real estate sector etc. During 2008, after the financial crisis, 8 out of the 14 companies included in this report, reported negative performance during 2008. This can be attributed mainly to several reasons: the global financial crisis, low sector diversification in their investment strategies (focus on securities and real estate), shortage of liquidity, liquidation of assets at low values, and short-term debt structure. These companies were highly exposed to the market movement mainly because they focused their investment strategies on the securities and the real estate markets in Kuwait and Bahrain. In spite of the fact that part of these investments comprise healthy real estate that generate cash flow most were financed through leverage and pledges to local banks. These assets were subject to margin calls and liquidation when banks refused to reschedule maturing debt obligations. This implies that some holding companies are heavily dependent on leverage and short-term financing evident by the high asset leverage ratios shown in the table (613% KIPCO, 598% Mena, 357% NIG, 235% MAZAYA, Kuwait Real Estate 210%, and 206% Privatization). Higher debt is translated into higher credit risk, and consequently, lenders may require shareholders' participation to reschedule debt payments. From a rating point of view, group and shareholders' likelihood of extraordinary support constitute one of the factors that should be considered before assigning a rating on the credit worthiness of an issuer.

Dividend Control

Dividend control is an important factor since it measures holding companies' abilities to gauge liquidity needs by using its influence over subsidiaries and associates. Holding Companies in Kuwait have the ability to strongly influence the financial policy and business operations of their subsidiaries as a result of their majority ownership in the subsidiaries (ranging from 35% to 100%). Accordingly, dividend flows and decisions of subsidiaries are mainly controlled by the holding companies interest. However, in light of the financial crisis, dividend payments were highly limited. Also, due to Central Bank decision, banks' ability to pay dividend were also constrained by the Central Bank's approval. A sound asset portfolio for holding companies should always concentrate on predominantly mature dividend producing assets (operating subsidiaries) as a source of liquidity.

Equity erosion

To examine the major drivers affecting the basic financial indicators a DuPont analysis is used. The majority of the holding companies included in this brief reported negative performance during 2008 and positive performance during 2009. Eight of the companies reported negative ROE ratios ranging from -58% for NIG to -3.89% for Kuwait Real Estate. This reflects a phenomenon of equity erosion which causes deterioration in the value of shareholders equity. The equity erosion trend exhibits further supporting evidence of deterioration of shareholders equity value. Upon comparison of the ratios from the previous year (2007), ROE ratios were all positive for all firms included in the sample and they ranged from 53.1% for KIPCO to 1.34% for MENA.

Moreover the asset turnover ratios, that measures holding companies' strength to generate revenue on their assets, were low which indicate the illiquid nature of these assets. The net debt to market measure was also significantly high (140% MAZAYA, 150% Kuwait Real Estate, 135% NIG) for the majority of firms included in the sample. This measure assumes that 30% of the investment portfolio is available for liquidation to meet short term debt repayments. In the past, holding companies were able to rely on a common practice of turning over or trading assets in their investment portfolio, hence, creating special purpose vehicle (SPV).

Debt structure of holding companies

The debt obligation profile for the holding companies is explained by several measures used in this report; debt ratios, asset leverage, and current liabilities to total debt. The current liabilities percentage was significantly high for the majority of the companies. The current obligations represent 84% MAZAYA, 99.8% Privatization, 96% Mashaer, 70% Safat, 98% Investors Holding Group, and 97% Al Safat of the total liabilities of these companies. This is further evidence that firms in Kuwait rely heavily on short-term debt to finance their needs. Note, though that Moody's had recently downgraded NIG to B1 from Ba3 (with negative outlook) and Standard & Poor downgraded KIPCO to 'BBB+' for long-term, and 'A-2' for short-term corporate credit ratings on CreditWatch with negative implications. Moody's justified the downgrade of NIG by the fact the group did not take strong action to improve the financial flexibility and to strengthen the debt capital structure. It was also attributed to the debt maturity profile which is geared towards short-term and uncommitted bilateral credit lines. For KIPCO, S&Ps justified the downgrade by KIPCO weakening portfolio characteristics as well as moderate likelihood support from majority owners and due to higher risk profile of the group largest holdings (United Gulf Bank & Showtime-Orbit). However, Capital Standards predicts strong support from the group' stockholders since they have supported them in the past.

Appendix

Key financial information as of Q3 2009

All values in KWD 000s (Q3 2009) (9 months)	Kuwait Projects Company (Holding)	Al Mazaya Holding Company	Mena Holding	Privatizati on Holding Company	Mashaer Holding Company	Kuwait Invest. Holding Company	Al-Safat Tec Holding Company	Investors Holding Group Company	National Industries Group Holding	AlSalam Group Holding Company	Human Soft Holding Company	Al Safat Energy Holding Company	Hits Telecom Holding Company	Kuwait Real Estate Holding Company
Revenue	367,918	59,160	7,719	5,588	8,704	3,741	20,059	770	68,201	412	4,671	7,972	94,814	2,728
Net Income	45,615	10,027	5,298	4,349	3,849	1,956	1,487	722	429	344	342	276	52	17
Assets	5,132,167	371,061	284,187	242,195	98,046	70,317	62,227	122,160	1,676,493	38,469	25,734	81,402	142,712	76,359
Liabilities	4,244,177	197,971	125,894	120,022	29,459	15,666	18,855	28,810	1,075,831	12,643	8,000	9,498	40,501	39,140
Net Worth	887,990	173,090	158,293	122,173	68,587	54,651	43,372	93,350	600,662	25,826	17,734	71,904	102,211	37,219
Current Liabilities	N.A.	165,914	16,629	119,820	28,272	NA	13,016	28,297	883,498	NA	2,431	9,206	32,627	34,165
DuPont Analysis														
Asset turnover(x)	0.07x	0.16x	0.03x	0.02x	0.09x	0.05x	0.32x	0.01x	0.04x	0.01x	0.18x	0.10x	0.66x	0.04x
Net Profit Margin (%)	12.40%	16.95%	68.64%	77.83%	44.22%	52.29%	7.41%	93.77%	0.63%	83.50%	7.32%	3.46%	0.05%	0.62%
Asset Leverage (Assets/Net worth) (%)	577.95%	214.37%	179.53%	198.24%	142.95%	128.67%	143.47%	130.86%	279.11%	148.95%	145.11%	113.21%	139.62%	205.16%
Return on Equity (%)	5.14%	5.79%	3.35%	3.56%	5.61%	3.58%	3.43%	0.77%	0.07%	1.33%	1.93%	0.38%	0.05%	0.05%
Return on Assets (%)	0.89%	2.70%	1.86%	1.80%	3.93%	2.78%	2.39%	0.59%	0.03%	0.89%	1.33%	0.34%	0.04%	0.02%

Portfolio Exposure	GCC, MENA, USA, UK	GCC, MENA	Kuwait, Egypt	Kuwait, Bahrain, Jordan	Kuwait, KSA, International	Kuwait, MENA, Asia	Kuwait	Kuwait, MENA	Kuwait, KSA, UK, Jordan	Kuwait & Foreign	Kuwait, EMEA	Kuwait, GCC, Asia	EMEA, Asia and Latin America	Kuwait
Business Segments	5	1	3	1	2	1	5	2	3	2-3	1	2	1	4-5
Controlled Entities in portfolio (%)	90%	90%-100%	90%-100%	77%	NA	NA	90%-100%	90%-100%	67%	90%-100%	90%-100%	90%-100%	100%	90%-100%
Current Liabilities/ Total Liabilities (%)	NA	83.81%	13.21%	99.83%	95.97%	NA	69.03%	98.22%	82.12%	NA	30.39%	96.93%	80.56%	87.29%
Total Debt/Total Assets (%)	30.26%	13.47%	NA	1.86%	NA	17.93%	13.19%	NA	50.37%	NA	15.84%	0.99%	1.93%	46.84%
Net Debt/Market Value of Portfolio Assets (%)	20.00%	140.00%	1.88%	114.80%	107.00%	35.20%	71.20%	NA	135.00%	NA	1349.00%	61.60%	8.70%	150.60%
Credit Rating	Baa1/BBB +	Not Rated	Not Rated	Not Rated	Not Rated	Not Rated	Not Rated	Not Rated	B1	Not Rated	Not Rated	Not Rated	Not Rated	Not Rated

Key financial information as FY 2008 and 2007

All values in KWD 000s FY 2008	Kuwait Projects Company (Holding)	Al Mazaya Holding Company	Mena Holding	Privatizati on Holding Company	Mashaer Holding Company	Kuwait Invest. Holding Company	Al-Safat Tec Holding Company	Investors Holding Group Company	National Industries Group Holding	AlSalam Group Holding Company	Human Soft Holding Company	Al Safat Energy Holding Company	Hits Telecom Holding Company	Kuwait Real Estate Holding Company
Revenue	440,296	138,254	31,607	5,945	19,366	(9,719)	25,365	(12,377)	(150,738)	(613)	7,356	12,773	97,838	2,691
Net Income	24,125	13,046	26,502	(13,737)	(19,910)	(15,435)	(8,052)	(24,358)	(281,963)	(604)	342	1,508	1,722	(1,432)
Assets	5,177,935	365,038	282,120	228,996	113,572	69,243	64,390	99,570	1,733,150	7,610	23,255	80,396	144,510	77,490
Liabilities	4,334,288	209,560	234,952	118,072	49,001	16,137	22,821	5,407	1,247,353	235	5,839	19,823	41,206	40,670
Net Worth	843,647	155,478	47,168	110,924	64,571	53,106	41,569	94,163	485,797	7,375	17,416	60,573	103,304	36,820
Current Liabilities	3,798,128	159,286	111,764	43,011	39,833	NA	16,340	5,407	901,819	234	4,059	10,959	34,017	19,239
DuPont Analysis														
Asset turnover(x)	0.09x	0.38x	0.11x	0.03x	0.17x	-0.14x	0.39x	-0.12x	-0.09x	-0.08x	0.32x	0.16x	0.68x	0.03x
Net Profit Margin (%)	5.48%	9.44%	83.85%	-231.07%	-102.81%	158.81%	-31.74%	NA	NA	NA	4.65%	11.81%	1.76%	-53.21%
Asset Leverage (%)	613.76%	234.78%	598.12%	206.44%	175.89%	130.39%	154.90%	105.74%	356.76%	103.19%	133.53%	132.73%	139.89%	210.46%
Return on Equity (%)	2.86%	8.39%	56.19%	-12.38%	-30.83%	-29.06%	-19.37%	-25.87%	-58.04%	-8.19%	1.96%	2.49%	1.67%	-3.89%
Return on Assets (%)	0.47%	3.57%	9.39%	-6.00%	-17.53%	-22.29%	-12.51%	-24.46%	-16.27%	-7.94%	1.47%	1.88%	1.19%	-1.85%
Current Liabilities/ Total Liabilities (%)	87.63%	76.01%	47.57%	36.43%	81.29%	NA	71.60%	100.00%	72.30%	99.57%	69.52%	55.28%	82.55%	47.31%
Total Debt/Total Assets (%)	28.73%	15.38%	3.37%	50.36%	NA	18.96%	14.08%	NA	66.01%	NA	13.47%	8.53%	8.43%	46.86%

All values in KWD 000s FY 2007	Kuwait Projects Company (Holding)	Al Mazaya Holding Company	Mena Holding	Privatizati on Holding Company	Mashaer Holding Company	Kuwait Invest. Holding Company	Al-Safat Tec Holding Company	Investors Holding Group Company	National Industries Group Holding	AlSalam Group Holding Company	Human Soft Holding Company	Al Safat Energy Holding Company	Hits Telecom Holding Company	Kuwait Real Estate Holding Company
Revenue	884,681	68,052	2,947	12,039	18,654	20,843	30,387	14,457	429,451	471	10,739	841	351	4,253
Net Income	521,691	24,571	57	8,583	7,853	13,081	3,008	13,506	209,364	483	4,579	475	644	2,236
Assets	4,278,998	250,655	6,802	253,464	129,113	97,395	75,413	124,686	2,159,593	10,284	21,468	11,133	9,846	65,393
Liabilities	3,296,564	151,330	2,558	91,829	52,941	23,178	25,842	2,097	1,029,176	1,939	4,933	5,514	833	24,057
Net Worth	982,434	99,325	4,244	161,635	76,172	74,217	49,571	122,589	1,130,417	8,345	16,535	5,619	9,013	41,336
Current Liabilities	NA	108,093	2,108	16,793	31,554	NA	17,792	1,550	682,826	1,370	1,992	5,488	NA	15,829
DuPont Analysis														
Asset turnover(x)	0.21x	0.27x	0.43x	0.05x	0.14x	0.21x	0.40x	0.12x	0.20x	0.05x	0.50x	0.08x	0.04x	0.07x
Net Profit Margin (%)	58.97%	36.11%	1.93%	71.29%	42.10%	62.76%	9.90%	NA	NA	NA	42.64%	56.48%	183.48%	52.57%
Asset Leverage (Assets/Net worth) (%)	435.55%	252.36%	160.27%	156.81%	169.50%	131.23%	152.13%	101.71%	191.04%	123.24%	129.83%	198.13%	109.24%	158.20%
Return on Equity (%)	53.10%	24.74%	1.34%	5.31%	10.31%	17.63%	6.07%	11.02%	18.52%	5.79%	27.69%	8.45%	7.15%	5.41%
Return on Assets (%)	12.19%	9.80%	0.84%	3.39%	6.08%	13.43%	3.99%	10.83%	9.69%	4.70%	21.33%	4.27%	6.54%	3.42%
Current Liabilities/ Total Liabilities (%)	NA	71.43%	82.41%	18.29%	59.60%	NA	68.85%	73.92%	66.35%	70.65%	40.38%	99.53%	NA	65.80%
Total Debt/Total Assets (%)	32.60%	25.85%	18.02%	35.22%	NA	16.74%	15.30%	NA	43.70%	7.75%	13.72%	7.72%	NA	34.80%

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