

Kuwait Real Estate Industry

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Summary

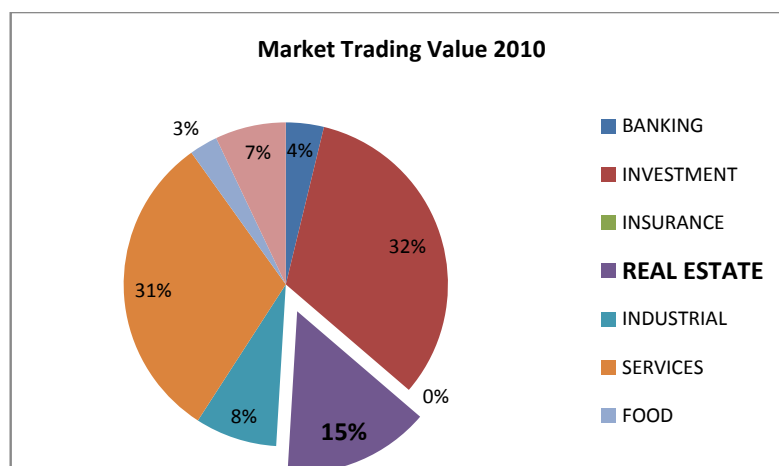
The real estate sector in Kuwait represents 15% of the total trading activities in Kuwait. The sector has 39 listed companies of different sizes and diversification scopes. The entire sector has undergone severe financial difficulties throughout the financial crisis with a total loss in market capitalization of 40% during 2009, and decrease in profits of 135% (534,654 mn KWD). The sector was further affected as a result of the change in the capital structure through higher reliance on short-term debt as well as the involvement in investment activities. For the first nine month period of 2009, the National Real Estate Company ranked the first and registered the highest net income level in the sector which reached 20,562 K followed by Mabani, ADNC, MAZAYA, Al Arabiya, and Salhia. As for revenue, MAZAYA ranked the first with registered value of 50,662 K followed by Mabani, Salhia, United Real estate, Enma and Dubai First.

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Industry Overview



The ownership structure in the real estate companies is very complex and overlaps with companies in other sectors. Moreover, most of the companies with special emphasis on banks have high asset concentration in real estate. Therefore, any regulatory, statistical or financial change in this sector is usually reflected in the rest of the industries. This is evident in the correlations Table 5, and the regulatory changes that the real estate has undergone in the past year (refer to factors that affect real estate sector in Kuwait 2004-2008 section).

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Financial Profile & Leverage

Capital Structure

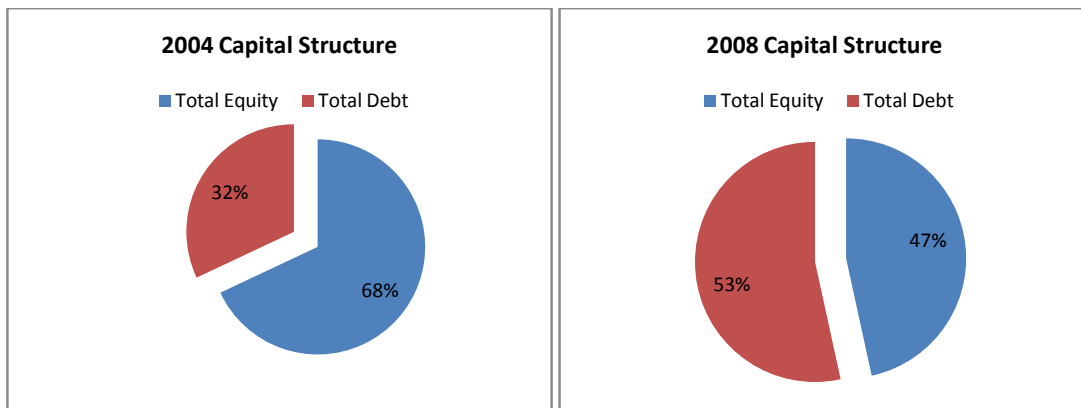
Table 1: Changes in the Capital Structure of the real estate companies (thousand KWD)

	2008	2007	2006	2005	2004
Total Equity	2,585,901	2,818,157	2,283,852	1,940,823	1,303,570
Total Liabilities	2,965,914	2,114,747	1,372,545	980,180	613,494
Total Assets	5,551,815	4,932,904	3,656,397	2,921,003	1,917,064
Growth in assets	13%	35%	25%	52%	-

Source: CSR analysis

In 2004, the capital structure of real estate companies has been highly reliant on equity. Gradually, this has changed to an even division of the capital structure between debt and equity in 2008. This can be explained by the high required rate of return by equity holders, and the relatively lower cost of debt financing. Due to the overinflated market bubble preceding the financial crisis, shareholders had very high expectations of the stock returns. Companies, therefore, have chosen debt as a more cost-effective source of financing.

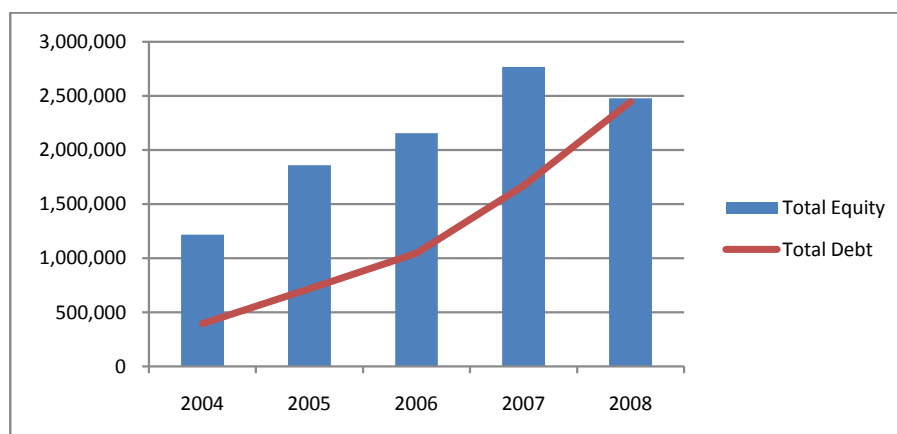
Moreover, banks and financial institutions have been lending entities and individuals with minimum analysis and study of their credit risk and default risk¹. This has led to many companies acquire high levels of debts and exposing themselves to severe financial risks in addition to high exposure to short term financing. The reliance on debt has proved to be costly throughout the financial crisis. Companies in Kuwait have faced huge financial and credit blunders which has caused severe consequences.



Most Real Estate companies in Kuwait have followed the same pattern. The companies have had low debt levels in 2004. However, due to the high required rates of return by investors and the low interest rates, along with the low credit requirements during the market boom, companies have decided to rely more heavily on debt. The outcome has been negative during the financial crisis of 2008 when companies have suffered huge losses due to the nature of their investment portfolio and financial risk profile.

¹ This is consistent with the United State's mortgage crisis.

Changes in equity as compared to debt (thousand KWD)



Source: CSR analysis

Liquidity

The liquidity of the real estate companies has been generally and on average sufficient in terms of liquidity. However, the level of liquidity, measured by current ratio, has been declining on a consistent basis for the past five years. The widest drop in liquidity has occurred in 2008 (50% drop in liquidity) as a result of the fall in values of marketable securities and increases in provisions. Liquidity and solvency positions of real estate firms were further deteriorated as a result of pressures to service debt payments; principal and interest.

Table 2: Asset Structure of Real Estate companies (thousand KWD)

	2008	2007	2006	2005	2004
Total Current Assets	804,216	1,175,307	925,474	819,430	333,157
Total Current Liabilities	1,545,917	1,149,346	692,595	357,461	156,678
Total Cash	234,630	189,310	138,808	123,076	129,853
Current Ratio	0.52x	1.02x	1.34x	2.29x	2.13x
Total Cash Ratio	0.15x	0.16x	0.20x	0.34x	0.82x
Cash as % of Assets	4.44%	4.02%	4.05%	4.51%	7.57%
Cash as % of Current Assets	29.17%	16.11%	15.00%	15.02%	38.98%

Source: CSR analysis

Performance

The performance of the real estate companies, measured by ROA in Kuwait was 7.4% on average during the period from 2004-2008. The total revenues and expenses have been increasing (revenues decreased from 107,135 mn in 2004 to 435,118 mn in 2008, expenses increased from 38,657 mn in 2004 to 224,054 mn in 2008). However, the total net income of those companies has been fluctuating drastically for that same period (from 188,195 mn in 2004 to a loss of -167,986 mn in 2008). The overall result of 2008 has been a total net loss (-167,986 mn), despite the fact that those companies have achieved the highest gross revenues for the past five years (435,118 mn). The sector experienced significant positive growth during the period before 2008 as a result of the strong economy coupled by high oil. However, the sector's favorable growth rates deteriorated during the past two years after the financial crisis.

Table 3: Performance of the real estate companies

	2008	2007	2006	2005	2004
Return on Assets	-3%	8%	5%	16%	11%
Return on Equity	-7%	13%	8%	23%	15%

Source: CSR analysis

Factors affecting Real Estate Sector in Kuwait (2004-2008)

Regulations

The Kuwaiti Parliament, in 2008, has passed a bill (Laws 8 & 9) that restricted trading of residential real estate property in an effort to eliminate speculations. The objective of these laws was to stabilize the unnecessary fluctuations in real estate prices and to help the government exercise more control over the speculation activities. The result of the enactment of these laws has been a drop in the real estate values in the entire country which was further worsened by the financial crisis that affected the real estate sector nationally and internationally.

Table 4: Real Estate prices per governorate (KWD per meter²)

Governorate (meter 2)	2008	2007	% Change
Hawally	603.1	695.5	-13.29%
Al Farwaniya	291.1	376.3	-22.64%
Mubarak Al Kabir	412.3	503.5	-18.11%
Kuwait City	704.9	742.4	-5%
Al Ahmadi	313	371.1	-15.6%

Source: Kuwait Finance House

The application of the laws has stirred controversy between the government and the investment entities and individuals. The investment entities have protested the laws and requested an immediate revocation, considering the law to be diminishing of the real estate values. However, the bubble in the real estate prices has been deliberately over-priced before activating the law. The current prices are more reflective of the values of the real estate properties.

The law was criticized by many commentators, since it allowed many companies to maintain their speculative activities under different guises, like forming temporary limited liability companies to perform those trading activities in the residential real estate properties. Many of the companies have managed to use the legal loopholes in the laws, thereby weakening its efficacy in reducing the real estate volatility.

On the other hand, there are active attempts to legalize and regulate the foreign ownership of real estate in Kuwait. This step is expected to revitalize the real estate sector in the country. The investment opportunities in Kuwait will have an impact on the other industries and facilitate the flow of cash in the country. However, the possibility of the law being passed and applied cannot be easily determined.

Investment Assets

The real estate companies in Kuwait have relied on the investment assets to generate their income for the past five years. This reliance has proved to be costly and has led to huge financial losses for most of the real estate companies.

Table 5: Correlations between Real Estate sector and other sectors

	Banks	Investment	Insurance	Industry	Services	Food	Non-Kuwaiti
Correlation with Real Estate	80%	94%	42%	45%	67%	44%	91%

Source: CSR analysis

The table shows the high (almost perfect) correlation between the investment sector and real estate sector indicates similarity in the assets held by the companies in the two sectors. Although the involvement in investment activities has added profits to the real estate companies' bottom line during the economic booms, the same involvement has proved to be an enormous loss during the financial crisis. This is normal provided the huge difference between the volatilities of investment assets and real estate. Investment assets are significantly more volatile than real estate.

Global Financial Crisis



Source: CSR analysis

The global financial crisis of 2008 has had an enormous impact on all assets values. The market values of almost all companies have dropped due to the convulsion between the different industries and sectors, which has its origins in the nature of the global market.

It is important to note that the global financial crisis has initially started as a mortgage/credit crisis. The financial crisis affected the sector severely because of the economic boom and the over-inflated assets' prices, in addition to the inadequate risk management practices applied by the banks and financial institutions.

The result has been a doubled failure for the banks. Many of these borrowers have failed to fulfill their obligations, thereby forcing the banks to liquidate their real estate holding. The prices of real estate have taken a huge hit by this episode.

Banks and financial institutions are major owners of real estate properties. Therefore, the default and liquidation cases have further aided in the decline of real estate values worldwide.

Low Interest Rates

Due to the weak risk management practices followed by banks on credit facilities and the need of the government to encourage consumer spending, interest rates were very low prior to the financial crisis. This pushed many companies to increase their reliance on debt in their capital structures and decrease their reliance on equity.

Table 6: Long term (3 year) lending rate

Year	2009	2008	2007	2006	2005	2004
Interest Rate	2.06%	3.75%	4.43%	6.37%	5.93%	4.00%

Source: Central Bank of Kuwait

The huge gap between the returns of Kuwait Stock Exchange and the returns on debt explains several observations regarding the real estate companies:

- I. The companies' reliance on debt rather than equity in their capital structures. Debt has been preferred by companies for the past several years as a result of the lower interest rates.
- II. The increase in investment assets in the companies' balance sheets. The companies have found it rewarding and profitable to engage in the market, given the high returns it has been achieving.
- III. The low cash reserves in the companies' asset bases and the lack of liquidity. The companies have used significant portions of its cash in investment assets.
- IV. The increased volatility in the overall returns of real estate companies. Although the real estate activities have been profitable, the overall results of the companies have been a net loss.

Increase in Required Rate of Return by investors

This factor is an elaboration on the previous point. Due to the increase in the market returns, companies have undergone pressure to satisfy shareholders either with high dividends or with a satisfactory market performance of the stock. This has added to the attractiveness of debt to finance projects and expansionary plans of the real estate companies.

Table 7: General Market Index performance

Year	2009	2008	2007	2006	2005	2004
Average return of KSE	10.2%	-38%	25%	-12%	79%	32%

Source: CSR analysis

Moreover, the shareholders represent a dispersion of the companies' ownership and control. The companies may therefore prefer debt since they do not want to share or disperse the control in the company.

Dubai and Saad & Al Gosaibi Crisis

Many of the companies in Kuwait –and in real estate in specific- are associated, affiliated, partially or entirely owned by another company. This has been a two-fold factor. On one hand, the companies could benefit from the support of external sources. On the other hand, companies will be negatively affected in case of a financial distress of one of its affiliates or associates occur.

According to what was released publicly of information about the exposure to Dubai restructuring case which forms a major shock to the confidence in the GCC region. According to local public media reports, two banks (National Bank of Kuwait and Ahli Bank of Kuwait) have had exposures to the Dubai crisis. Four banks, according to the same reports, (National Bank of Kuwait, Ahli Bank of Kuwait, Gulf Bank, and Kuwait Finance House) have been involved or exposed to the Saad and Al Gosaibi restructuring event.

These events have proved two things; first, that companies in the GCC are no longer isolated from the international arena, given the interconnectedness of the global financial system. Second, that companies supported or owned by the government do not necessarily have immunity against defaults, restructurings and financial distress.

Real Estate Companies²

Revenues

The next Table shows the real estate companies in Kuwait organized by size of revenue of 9 months 2009.

Table 8: Revenues of Real Estate companies (thousand KWD)

	2009 (9 m)	2008	2007	2006	2005	2004
Mazaya	50,662	130,462	32,054	42,678	19,136	6,952
Al Mabani Real Estate	34,489	36,312	15,300	10,390	1,177	170
Salhia Real Estate Company	31,923	0	0	0	0	0
United Real Estate Company	21,888	21,455	19,183	16,739	14,289	14,163
Enma'a Real Estate Company	14,886	14,886	26,750	29,464	30,030	23,035
Dubai First	13,037	98,675	4,525	2,047	1,591	0
Tamdeen Real Estate Company	8,119	11,676	11,625	8,252	7,643	5,938
Kuwait Real Estate Company	7,701	10,343	8,882	573	7,677	7,493
National Real Estate Company	6,460	8,030	7,677	16,290	16,157	15,670
A'ayan	5,793	6,587	418	564	482	466
Al Masalih Real Estate Company	5,579	6,368	5,002	4,167	1,849	2,027
Argan	4,280	16,533	17,645	17,750	0	0
Al Ta'ameer	3,265	3,120	1,485	1,242	495	0
Al Arabiya Real Estate Company	2,680	2,398	2,925	6,674	4,556	2,699
Injazzat	2,469	22,398	18,820	12,088	14,656	1,013
Ream	1,543	2,413	1,419	1,358	900	844
Itihad Real Estate Company	1,204	1,419	1,349	1,991	1,986	1,883
Manazil	1,153	1,078	2,939	4,614	24	0
Ajial Real Estate Company	1,087	1,472	1,361	1,380	1,404	1,513
Monsha'at	938	10,886	8,418	26,472	26,722	0
Al Tijara	723	568	368	2497	2968	3998
Arkan	569	571	415	305	206	NA
Abyaar	464	6,095	17,389	1	0	0
Al Thimar	343	12,132	2,830	1,163	973	630
International Resorts	60	109	244	0	0	0
International Investors	0	109	218	244	2554	0
Jeezan	0	0	0	0	0	1953
Senam	0	0	0	0	0	0
Aqar	0	0	2090	898	0	0
Grand	0	0	0	0	352	529
Medinat Al A'mal	0	0	0	0	0	0
ADNC	-1,371	-5,568	3,960	4,121	4,589	2,194
Pearl of Kuwait Real Estate Company	NA	3,447	886	2,734	5,915	2,268
Safat Global	NA	235	420	382	0	0

² The source of the following data is analysis conducted by CSR.

Net Income

This is a table of real estate companies in Kuwait, organized by the net income of 2008.

Table 9: Net Incomes of Real Estate companies (thousand KWD)

	2009 (9 m)	2008	2007	2006	2005	2004
National Real Estate Company	20,562	18,292	39,021	34,251	53,608	34,462
Al Mabani Real Estate	15,310	6,225	18,306	10,031	13,938	3,093
ADNC	10,169	-27,067	1,398	1,578	13,619	2,512
Mazaya	10,027	13,046	24,571	23,431	14,008	6,185
Al Arabiya Real Estate Company	5,882	70	5,655	3,585	8,435	4,276
Salhia Real Estate Company	5,183	-35,495	30,977	49,031	17,501	10,189
Abyaar	5,008	5,957	16,840	12,020	7	0
Kuwait Real Estate Company	3,960	-46,844	30,253	-9,776	62,108	25,710
Argan	3,351	9,760	9,140	5,534	0	0
Injazzat	2,818	15,326	16,479	10,212	15,238	4,487
Al Thimar	2,504	288	20,409	3,903	7,450	411
A'ayan	2,228	6,878	6,169	4,337	1,105	764
Tamdeen Real Estate Company	2,018	13,593	11,562	4,530	8,185	5,653
United Real Estate Company	1,855	6,114	10,215	13,525	12,540	13,405
Monsha'at	1,474	9,675	5,584	27,217	36,939	0
Itihad Real Estate Company	995	-2,486	4,267	2,674	2,934	2,584
Senam	865	115	1434	381	1624	692
Ream	811	906	1,066	966	420	373
International Investors	722	-24,358	13,506	104	7,092	3,120
Al Masalih Real Estate Company	31	-3,968	3,070	-42	2,406	1,769
Aqar	-49	-1,180	1,735	760	1,973	1,143
Jeezan	-667	-20,738	14,002	-30,590	33,159	16,204
Al Tijariya	-700	-3,159	5,706	7,681	7,674	4,759
Al Ta'ameer	-1,213	-5,139	649	-123	7,722	0
International Resorts	-1,373	573	2,234	-7,217	6,952	2,644
Medinat Al A'mal	-1,572	-1,656	5,115	0	0	0
Arkan	-1,638	2,936	3,531	3,010	2,199	NA
Ajial Real Estate Company	-4,782	-9,340	6,655	4,076	7,606	9,124
Enma'a Real Estate Company	-8,321	-8,321	6,763	10,131	8,221	7,732
Grand	-8,587	-31,534	20,756	19,257	13,799	2,549
Manazil	-8,792	-8,453	6,000	6,412	6,086	0
Dubai First	-9,195	-5,440	4,525	3,283	3,003	0
Pearl of Kuwait Real Estate Company	NA	4,271	134	3,527	4,085	1,400
Safat Global	NA	0	817	310	0	0

Technical Analysis/Market Performance

The following are the statistical figures of the entire industry performance between January 2008 and January 2010.

Factor	Figure
Change	-53%
Volatility	42%
Average daily trades	1401
Average value per trade	10,467
Average daily volume	86,072,725

Source: CSR analysis`

Observing the statistical performance of the real estate sector confirms the earlier conclusion regarding the importance of the sector in Kuwait stock exchange. The industry’s companies are volatile. However, real estate is responsible for a significant portion of the activity in the General market index.

Therefore, it is natural that the change in the volatility of the real estate sector will have a direct impact in the rest of the market. Moreover, statistically, real estate has always been amongst the top three performers in the industries in Kuwait.

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