KAMCO Research

Kuwait Banking Sector

December - 2014

Company Name	CMP *(25 Dec 14)*	Target Price	Upside/Downside	KAMCO Rating
National Bank of Kuwait	***0.890***	***1.006***	***+13.0%***	***Outperform***
Kuwait Finance House	***0.740***	***0.755***	***+2.1%***	***Neutral***
Gulf Bank	***0.290***	***0.351***	***+21.0%***	***Outperform***

In this Report...

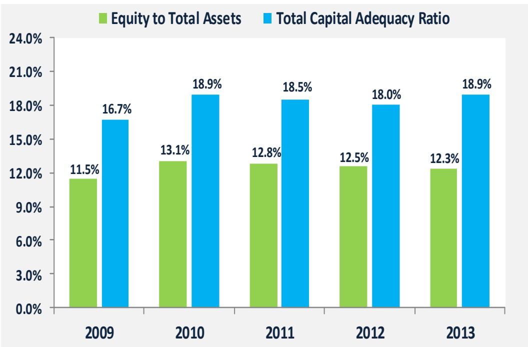
Banking system in Kuwait is one of the most developed amongst its GCC peers *with a credit penetration rate of 72% by 2013, compared to around 59% for its GCC benchmark. This in turn implies promising growth potentials for the sector as credit and default risk normalizes.*

Kuwaiti banks have fared well amid the hostile operating conditions*, maintaining their adequate financial standing and continuing to grow at satisfactory levels. Kuwaiti banks had a robust capital adequacy with a CAR of 18.9% in 2013 compared to GCC average of around 18%.*

The largest risk factor to sector earnings remains to be the high level of provisioning & impairments. *System-wide asset quality indicators have seen gradual improvement over the period 2010-2013 as Kuwait banks' NPLs to gross loans considerably improved to 4.7% at end-2013, down from its peak in 2009 of 10.3%, yet still somehow below its GCC benchmark NPL ratio of around 3.8% at the end of 2013. As well, Kuwaiti banks managed to improve their coverage of NPLs over the last 3 years to reach 111% by the end of 2013.*

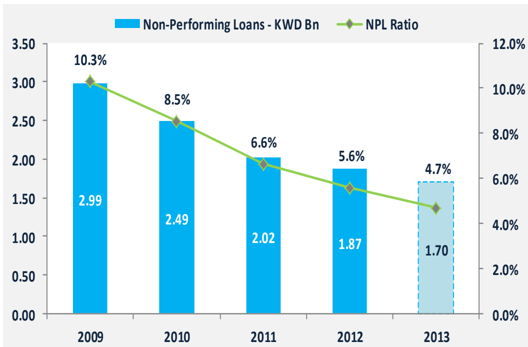
Kuwait Banking system overall NIM has been on the decline over the last 5 years *to reach 3.3% in 2013 down from 3.6% in 2008. Nevertheless, total Net Interest Income (NII) saw a gradual yet slight improvement over the same period, to grow by a CAGR of 4.1%, driven by the higher lending volumes.*

Sector Capital Adequacy



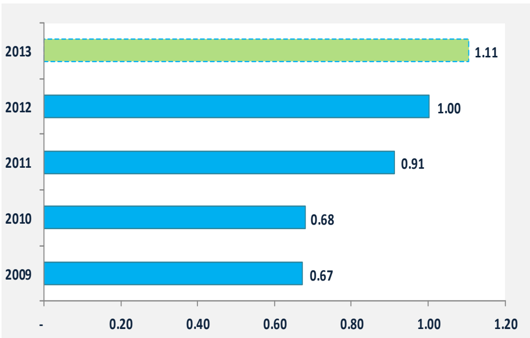
Source: Companies' Financials & KAMCO Research

Quality of Loan Portfolio



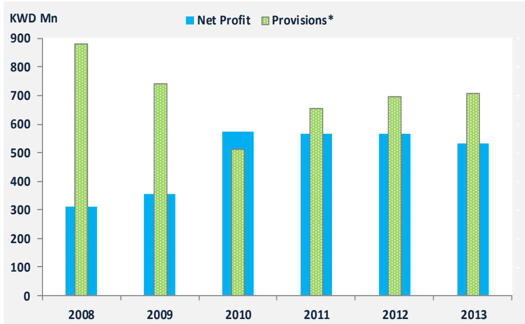
Source: Companies' Financials & KAMCO Research

Coverage Ratio



Source: Companies' Financials & KAMCO Research

Provisions & Profitability



** Provisions includes Impairment Losses during the year*

Source: Companies' Financials & KAMCO Research

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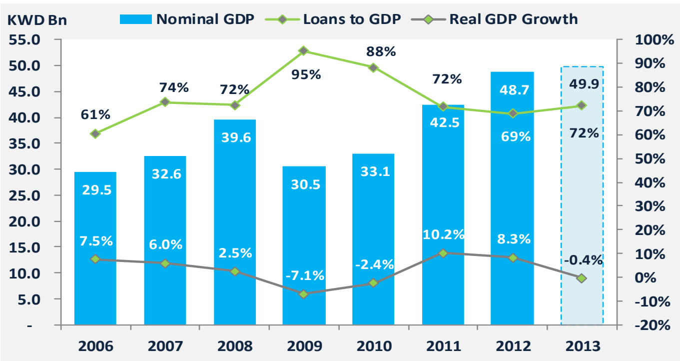
Macroeconomic Background

Macro-Economic Drivers and the Banking System

Kuwait has the 4th largest economy in the GCC region with a GDP of KWD 49.8 billion as of 2013. In real terms, GDP growth is still subdued owing to the sluggish economic conditions across the globe. On the other hand, the Banking system in Kuwait is one of the most developed amongst its GCC peers with a credit penetration rate of 72% by 2013, compared to around 59% for its GCC benchmark. This in turn implies promising growth potentials for the sector as credit and default risk normalizes and banks relax their lending policies.

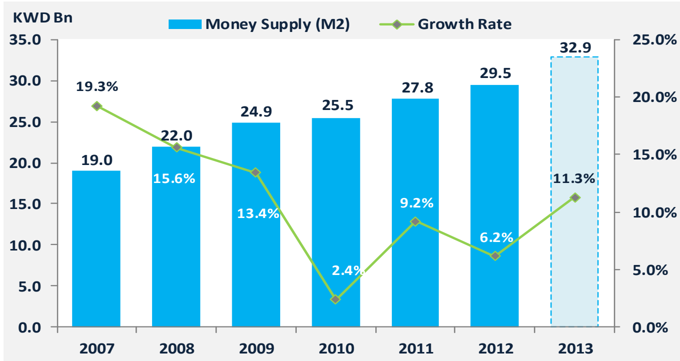
Kuwait Interbank rates followed the same downward trend as global benchmarks since the onset of the financial crisis back in 2008, when central banks across the globe cut the benchmark rates to the lowest levels ever, in response to tight liquidity environment. As well, KIBOR-LIBOR spread has somehow widened over the same period, reflecting the higher perceived risk in the local economy.

GDP & Credit Penetration Rate



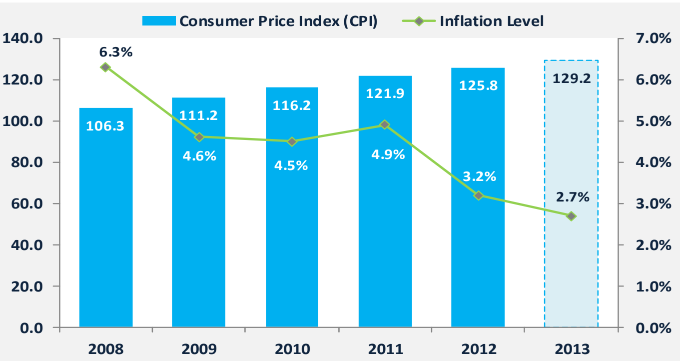
Source: IMF & KAMCO Research

Money Supply



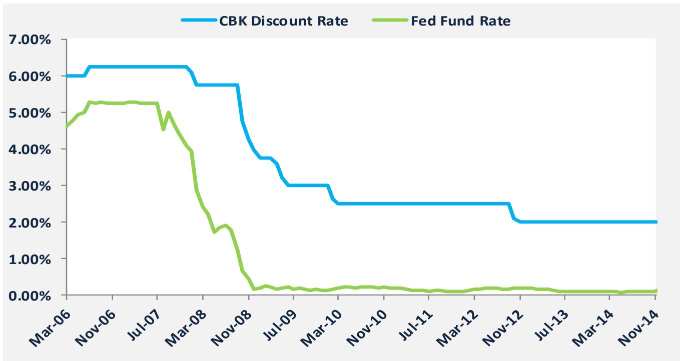
Source: Central Bank of Kuwait

CPI & Inflation Rates



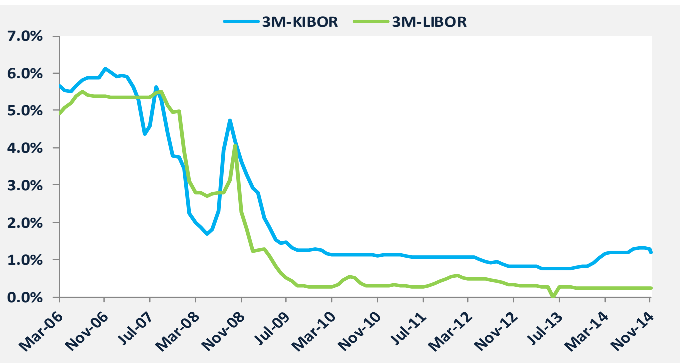
Source: Central Bank of Kuwait and IMF

CBK Discount Rate & Fed Fund Rate



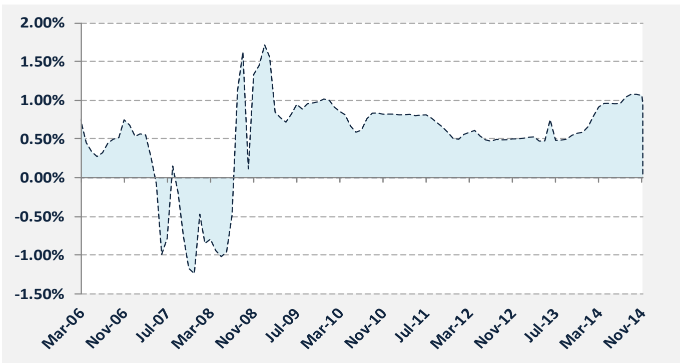
Source: Bloomberg

3M-KIBOR vs. 3M-LIBOR



Source: Bloomberg

3-Month KIBOR / LIBOR Spreads



Source: Bloomberg

Kuwait Banking Sector

Surrounded by an unusual global, regional and domestic environment, Kuwaiti banks have fared well amid the hostile operating conditions that have been prevailing across all markets, maintaining their adequate financial standing and continuing to grow at relatively lower but still satisfactory levels.

The high liquidity level of the Kuwaiti Banks along with the effective and prudent measures set by the central bank represents a crucial point for the banks in mitigating the effects of the tight market conditions and low operating activities. However, the pre-emptive measures taken by banks to increase their reserve level has been weighing down on bottom line results.

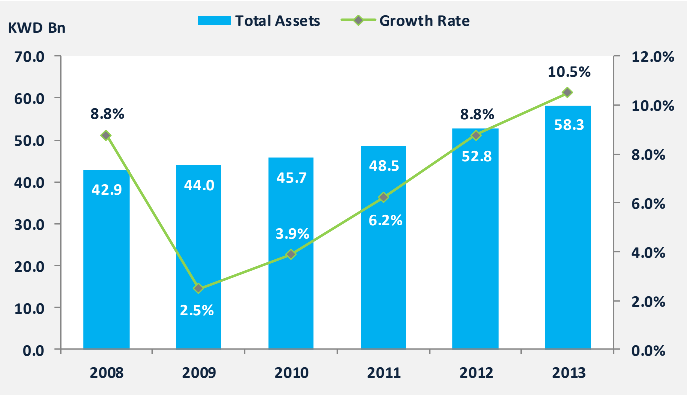
Moreover, the main concern for the sector lies in the amount and timing of additional provisions that banks are expected to take as they aim to increase their general/specific provision.

Asset Structure

Kuwaiti Banks' Asset Base - Gradual Recovery in Growth

System-wide assets base has grown at a compounded annual rate of 6.3% over the last 6 years, to stand at KWD 58.3 billion as of Dec-2013. Despite that the annual growth seen over that period is still far below the remarkable historical averages, owing to the slow progress in the credit side, it is noticeable that the rate of growth has been rising steadily since 2009; this implies that a healthy recovery is gradually taking place in Banking system in Kuwait.

Evolution in Sector's Total Asset Base

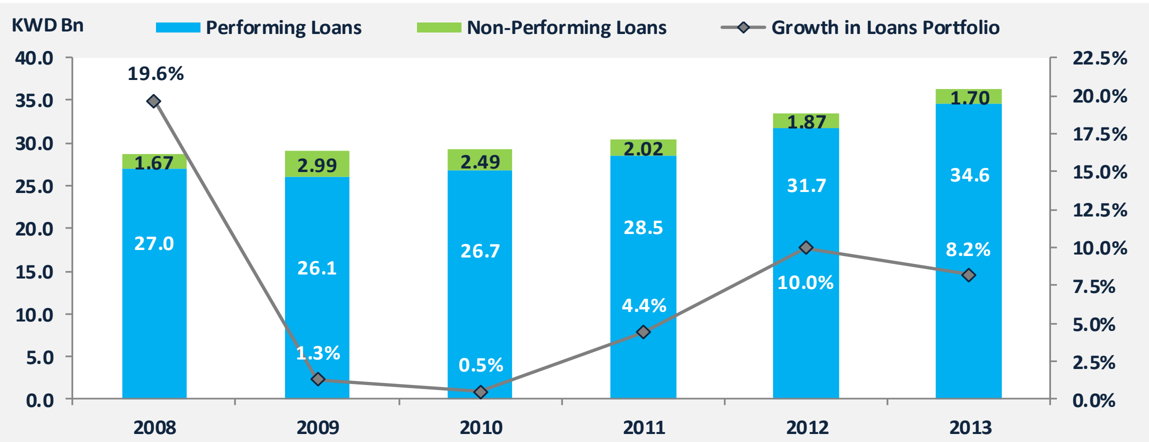


Source: Companies' Financials and KAMCO Research

Loans Portfolio & Market Share

On the lending front, Kuwaiti Banks' loans portfolio stood at KWD 36.3 billion, growing by a compound annual rate of 4.8% over the last five years. On the other hand, a recovery in the quality of the loans is apparent, where NPLs is on the decline since 2009 to represent around 4.7% of gross loans as of 2013.

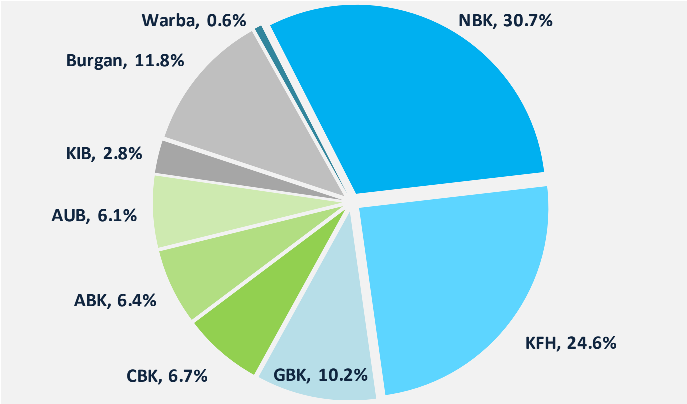
Size and Growth of the Sector's Loans Portfolio



Source: Companies' Financials and KAMCO Research

The Banking sector in Kuwait has a concentration in the loan portfolio with the top four banks controlling around 77.3% of the loan market as of Dec-2013. NBK retains the largest loan portfolio or around 30.7% of the system aggregate, followed by Kuwait Finance House, Burgan bank and Gulf Bank, with a respective loan market share of around 24.6%, 11.8% and 10.2% as of Dec-2013.

Banks' Market Share of Loans Portfolio - 2013



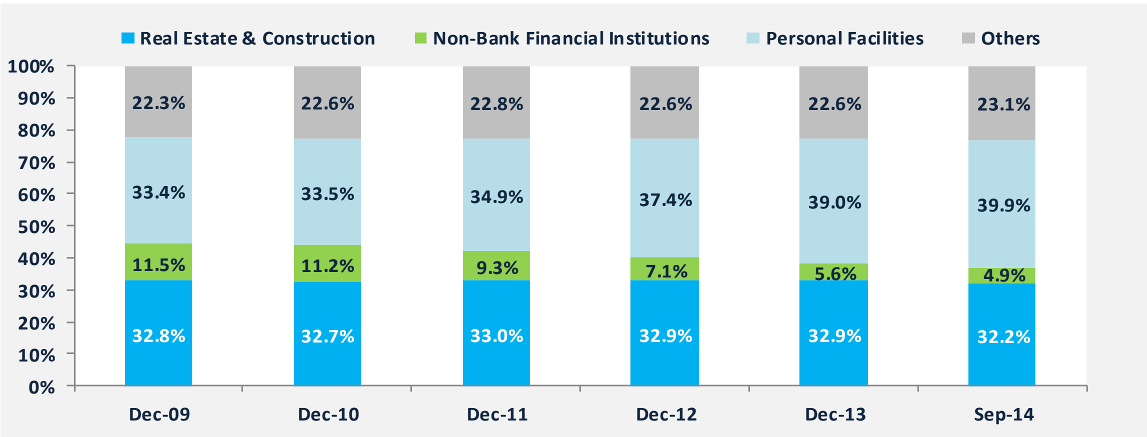
Source: Companies' Financials and KAMCO Research

Loans by Type - High exposure to Real Estate and Investment Companies

Concerns over the previous years were centered into the exposure to Real Estate and Investment Sectors being the prime reason for the high level of Banks' NPLs, provisioning expenses and impairments. The sectoral analysis of Banks' credit shows that Kuwaiti Banks remain to be highly exposed to these two troubled sectors, however, the combined exposure to RE and Investment Companies dropped to 38.5% by 2013 from a high of 44.3% as of Dec-09, as banks refrained from granting additional credit facilities to these sectors and at the same offered debt restructuring to some of the companies. Moreover, the exposure to the RE and Investment Sectors have further dropped as of Sep-2014 to reach around 37.1% of the total loan book.

Moreover, it is to be noted that this ongoing process of reducing the exposure and credit concentration to specific sectors was predominately obvious for the Investment Sector in which the Banks' exposure dropped from 11.5% in 2009 to 4.9% as of Sep-2014; whereas the exposure to RE and Construction Sector remains at a high level of around 32.2% as of Sep-2014 which entails a high level of prudence and precautionary measures.

Credit Concentration by Sector



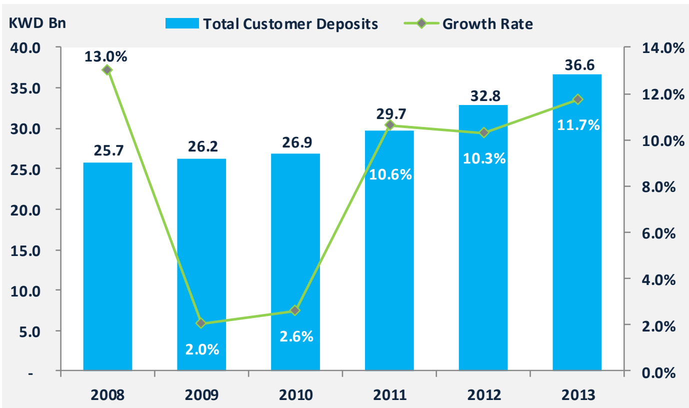
Source: Central Bank of Kuwait and KAMCO Research

Funding & Equity Base

Evolution in Sector's Customer Deposit Base

Total customer deposits showed a compounded annual growth of 7.4% over the last 5-year period, to stand at KWD 36.6 billion by the end of 2013, up from KWD 25.7 billion as of Dec-08. Despite the fact that growth in deposits is still unmatched compared to historical levels, the magnitude of the growth in deposits has gradually picked up over the last three years as the rise in oil prices has triggered the growth in the local economy.

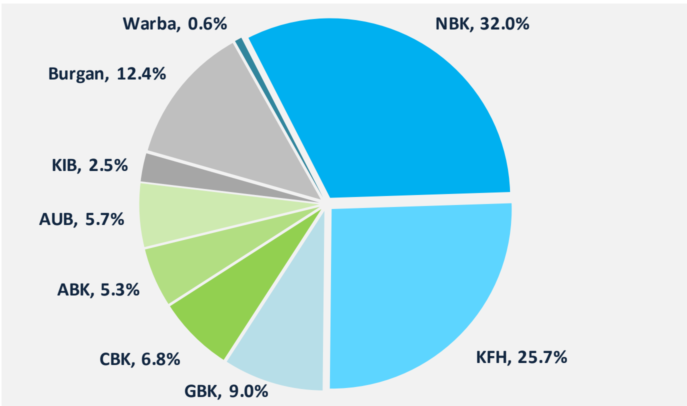
Bank's Customer Deposit Base



Source: Companies' Financials and KAMCO Research

Total deposits of the Banking Sector remain concentrated with the top 4 banks controlling around 79% of the aggregate deposit base. NBK and KFH are by far the biggest banks in Kuwait, where NBK holds the biggest portion of deposits of around 32%, followed by KFH by around 25.7%; whereas, Burgan bank and Gulf bank together have around 21.4% of the aggregate sector deposits as of Dec-2013.

Banks' Market Share of Deposits

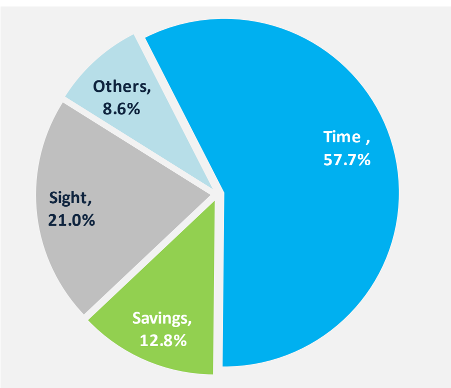


Source: Companies' Financials and KAMCO Research

Funding Structure

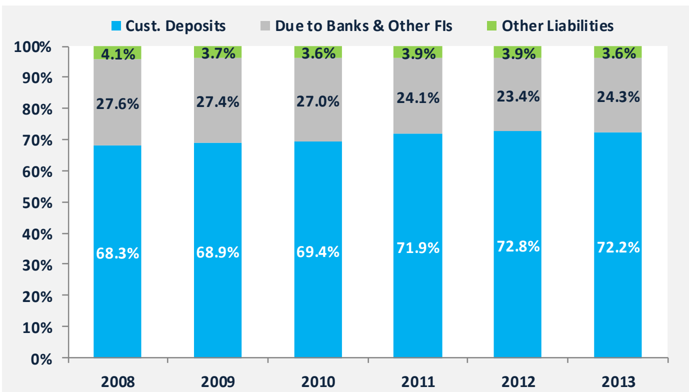
Deposits from customers make up the major portion of the funding base for Kuwaiti Banks, representing around 72.2% by in 2013. In terms of deposit base by category, Kuwaiti banks have a relatively high-cost deposit base as Interest bearing time & saving deposits account for around 70% of total customer deposits. On the other hand, government and government-related entities' deposits accounted for 14% by the end of 2013, which grant additional strength to Banks' funding base.

Customer Deposits by Category



Source: Companies' Financials and KAMCO Research

Sector Funding Mix



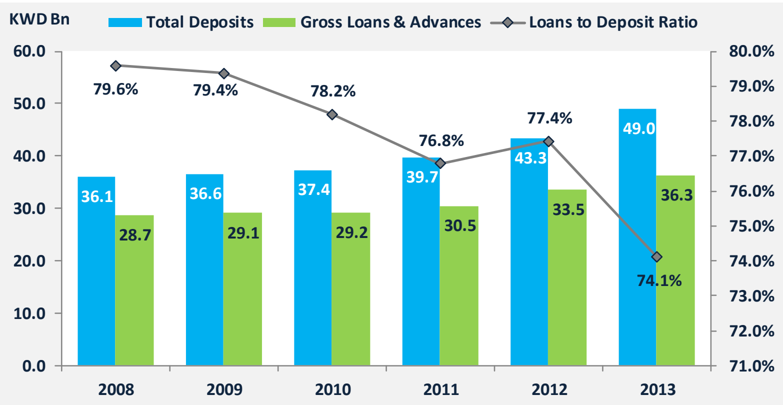
Source: Companies' Financials and KAMCO Research

Sector's Loans to Deposits Ratio

Banks' risk averseness on the lending front along with a low risk-adjusted return opportunities in the market and a pick up in economy activities have resulted in higher growth magnitude in deposit base vis-à-vis loans volume, hence ultimately leading into lower loans to deposit ratio across the sector.

The ratio of loans to deposits stood at 74.1% as of Dec-2013, down from around 80% back in 2008-2009 and fairly below historical average ratio. However, this provides Banks with a room for future expansion as market and economic conditions bounce back to normal levels; this is particularly true for large banks as they have the lowest L/D ratio among the industry and relative to historical levels.

Kuwait Banking Sector Loans & Deposits



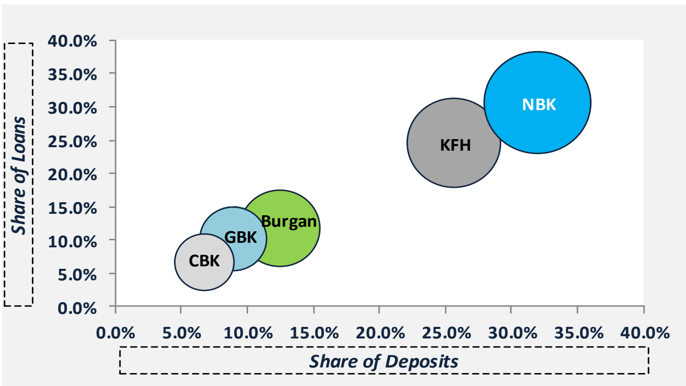
Loans to Deposits Ratio	2013	5-year Avg.
NBK	71.1%	75.1%
KFH	71.1%	74.4%
Burgan	70.4%	71.4%
GBK	84.6%	86.5%
CBK	73.5%	78.2%
ABK	90.2%	87.5%
AUB	79.8%	79.6%
Boubyan	80.0%	78.9%
KIB	81.5%	82.5%
Warba	71.1%	69.1%
Industry Overall Ratio	74.1%	77.2%

Source: Companies' Financials and KAMCO Research

Concentration of Loans and Deposits

By all standards, the Banking Sector in Kuwait is highly concentration with the top few Banks controlling the majority of loans and deposits. The biggest two banks, NBK and KFH controls more than half the portion of the sector's aggregate size, whereas the relatively mid-sized banks, namely Burgan Bank, Gulf Bank, and Commercial Bank of Kuwait together correspond to around 28% of the Sector's loans & deposits base.

Top 5 Players in the Market in terms of Loans & Deposits

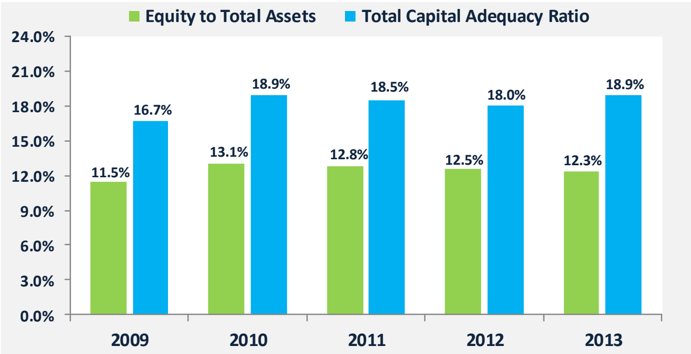


Source: Companies' Financials and KAMCO Research

Adequate Capital: A Source of Strength

Kuwaiti banks are characterized by a robust capital adequacy with Tier 1 capital and total capital ratios showing steady improvement over the last 5 years. After reaching a low of 15.6% in 2008, down from 19.3%, total capital ratio for local banks gradually increased to reach 18.9% at the end of FY-2013. More importantly, Kuwait banks maintained a solid equity base and their equity-to-assets ratio is considered relatively high at around 12.3% by the end of 2013. Having said that, Kuwait possesses a well maintained and stable banking system that, with the proactive role of the CBK, makes it the prime and most secure sector.

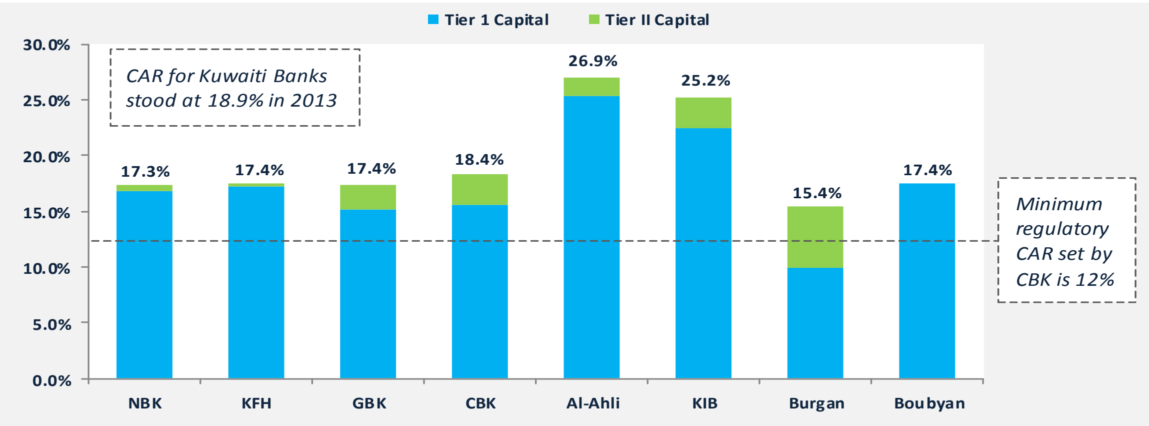
Banks' Capital Adequacy & Solvency Ratios 2009 - 2013



Source: Companies' Financials and KAMCO Research

The historical analysis of individual local banks' capital base shows that all of the banks are amply capitalized with the top tier banks having a CAR ranging between 17% to 19%, which is far above the 12% minimum regulatory ratio set by the CBK. Furthermore, banks have a very high Tier 1 capital ratio ranging between 15% and 17% for top banks, except for Burgan bank at 10%. Given this high level of capital adequacy, the implementation of Basel III will not have a material impact on banks.

Kuwaiti Banks Capital Adequacy Ratio - 2013



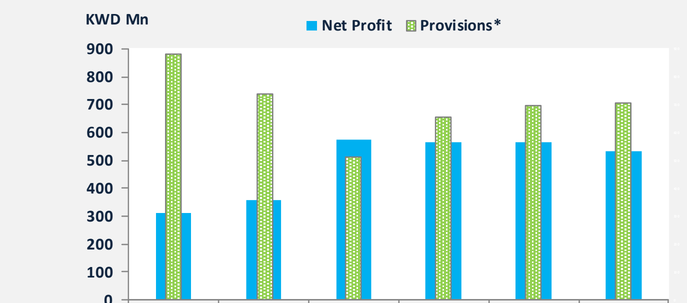
Source: Companies' Financials and KAMCO Research

Sector Profitability & Efficiency

Provisions & Impairments continue to heavily weigh on bottom line results

In broad term, the banking sector reported a compounded annual growth of 11.4% in Net Profit over the last 5-year period, despite the marginal annual drops seen in profitability during FY 2011 & FY 2013, owing to the increased level of provisions & impairments taken by the majority of the banks and the low interest rate context prevailing in the market. The last three years were characterized by a high cost of risk for banks in which the level of provisions has followed an upward trajectory. This was particularly true for large banks where the total amount of provisions and impairments taken by the top 4 banks (NBK, KFH, Burgan, and Gulf Bank) amounted to 618 Million or around 88% of the total sector provisions for loan losses and impairments during FY 2013 which amounted to KWD 706 Million. On top of that, the overall tough operating atmosphere characterized by the slow-moving economic conditions and ensuing pressures on fee income generation as well as interest margins and spreads ultimately lead to stagnation in bottom line results for most of the banks, and therefore lower return levels.

Sector Net Profit relative to Provisions 2009 - 2013



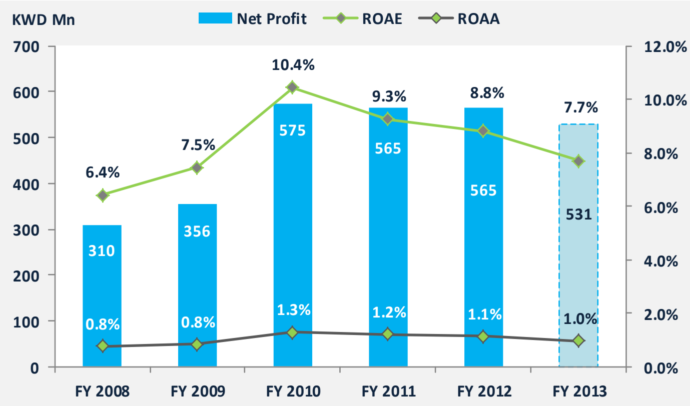
	2008	2009	2010	2011	2012	2013
Net Profit	310	356	575	565	565	531
Provisions*	879	740	509	653	695	706

** Provisions include Impairment Losses during the year*
Source: Companies' Financials and KAMCO Research

Underperforming Profitability Measures

A rebound in return measures was not seen so far in Kuwait and the sector performance is still viewed to be far away from the soaring performance witnessed before the financial crisis. In this context, the overall core profitability ratios as measured by the Return on Average Equity (ROAE) and Return on Average Asset (ROAA) are still at the low end standing at 0.9% and 7.7%, respectively, for FY 2013. Moreover, the comparative regional analysis shows that the sector's ROAA and ROAE are underperforming relative to its GCC benchmarks and are far below the respective overall average of 1.8% and 12.8% for the year 2013. Such a contracted level of profitability ratios mainly owes to the high level of general and specific provisions that banks have been taking since the onset of the financial crisis as the bad debt burden remains a concern for banks despite the significant write-offs of NPLs and the substantial restructuring of problematic assets.

Profitability Measures 2008 - 2013



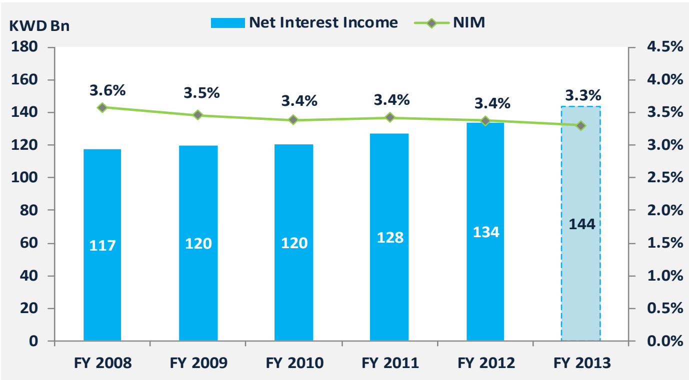
Source: Companies' Financials and KAMCO Research

As well, on the operational level, it is to be noted that the pressurized interest margins, spreads and net operating margins contributed to the overall contraction in return ratios for Kuwaiti banks as it is the case in the regional and global markets.

A standstill in Key Margins and Spreads

Within the framework of an obstinately low interest rate environment putting pressure on spreads and interest margins, Kuwait Banking System overall NIM has been on the decline over the last 5 years to reach 3.3% in 2013 down from 3.6% in 2008. Nevertheless, total Net Interest Income (NII) saw a gradual yet slight improvement over the same period, to grow by a CAGR of 4.1%, driven by the higher lending volumes.

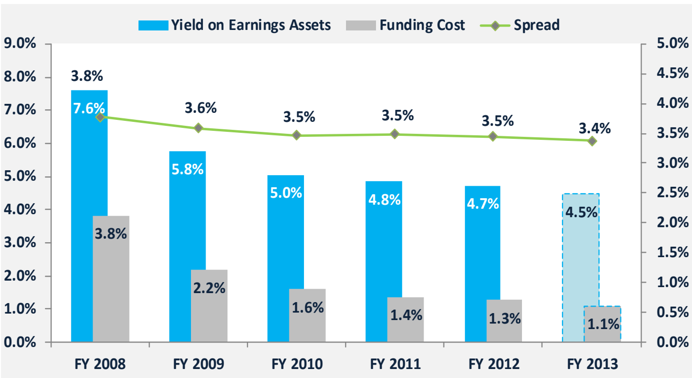
Net Interest Income and Margin FY 2008 - 2013



Source: Companies' Financials and KAMCO Research

In the same context, interest spread followed the same trend to reach 3.4% in 2013 down from a high of 3.8% in 2008, as the drop in interest rates had a greater impact on the yield on earnings assets than on the funding cost, with the latter currently standing at a near to the ground level of 1.1%, down from 3.8% in 2008, or around 270 bps; whereas yield on earnings assets dropped by around 310 bps over the same period.

Sector's Major Profitability Margins

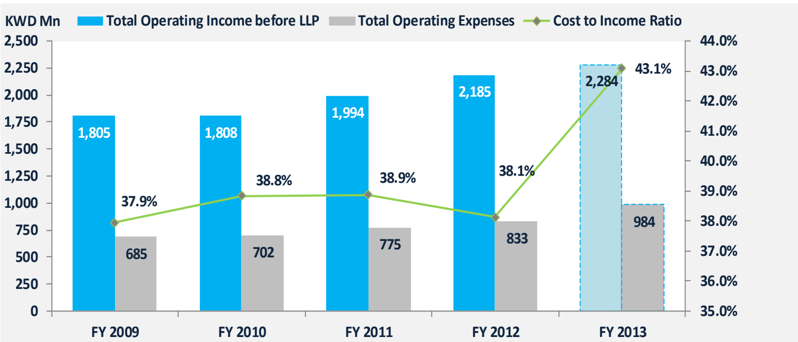


Source: Companies' Financials and KAMCO Research

Challenging Operational Activities and Efficiency

On the back of subdued economic conditions, low brokerage activities and low income growth from core business, total operating income of the sector recorded KWD 2.28 Billion in FY 2013, growing at a CAGR of 3.9% over the period 2008-2013, compared to a historical average growth of around 26% between 2004-2008. While on the other hand, amid an increasingly inflationary cost environment and in line with banks' expansionary strategies, sector overall operating expenses increased by a compounded annual rate of 9.1% over the last 5-year period to record around KWD 1 Billion in 2013. Accordingly, sector's cost to income ratio has gradually increased to reach 43.1% in 2013 as compared to a ratio of 37.8% in 2009 and an average ratio of around 30% over the period 2004-2008.

Sector Overall Operating Efficiency



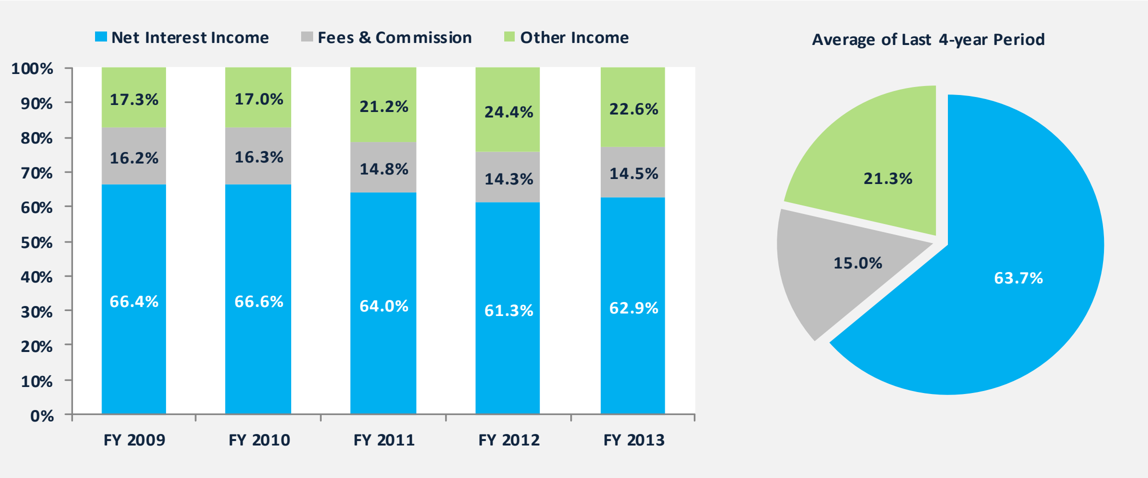
Cost to Income Ratio	2013	5-year Avg.
NBK	33.1%	31.6%
KFH	54.1%	51.5%
Burgan	44.5%	37.5%
GBK	34.4%	31.9%
CBK	24.1%	22.2%
ABK	29.5%	30.1%
AUB	30.9%	34.9%
Boubyan	45.5%	51.2%
KIB	43.5%	49.6%
Industry Overall Ratio	43.1%	39.4%

Source: Companies' Financials and KAMCO Research

Contribution by Type of Revenue and Growth Trend in Revenues

Net Interest Income (NII) represents the largest contributor to operating income for Kuwaiti banks, generating around two-third of the system operating revenues. Over the last 5 years, NII as a proportion of total operating income dropped to around 63% in 2013, down from 66.4% in 2009, mainly owing to the tight interest margins and spreads. As well, the share of fees & commission income to total income has followed the same declining trend, to now represent around 14.5% down from 16.2% in 2009. Having said that, the contribution of Other Income jumped from 17.3% in 2009 to reach 22.6% in 2013, on the back of improved return from investment activities and higher FX gains.

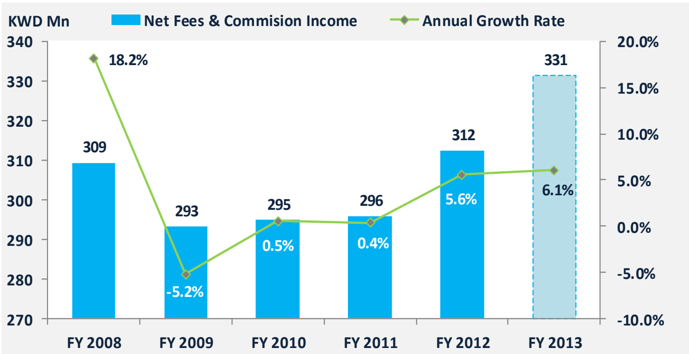
Evolution in Revenues by Type of Income



Source: Companies' Financials and KAMCO Research

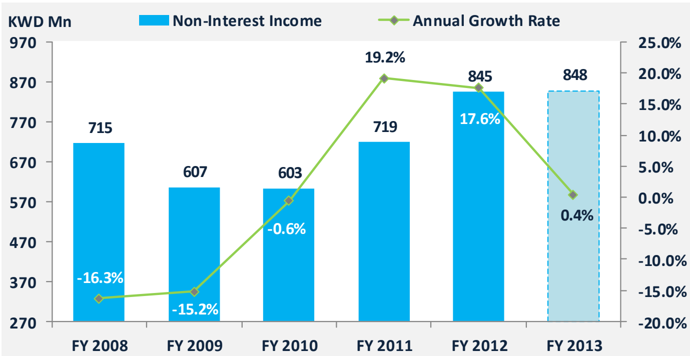
In general, the change in the contribution by key income generating activities for Kuwaiti banks is mainly attributable to the sluggish domestic as well as regional macro-economic environment confining the growth in interest income and fees & commission's income mainly during 2011-2012. This is in addition to the strict policies by banks in extending high quality loans in order to avoid further increase in NPLs and hence more provisioning. Such a situation, along with the pick up in equity market performance during that period, have led to a considerable increase non-interest income (mainly from investments) which grew by 19.2% and 17.6% in FY 2011-2012. However, it's worth noting that the growth rates in fees & commission income and NII have progressively increased over the last 2 years, indicating a restoration is taking place in core activities of the sector.

Historical Growth Trends in Fees & Commission Income



Source: Companies' Financials and KAMCO Research

Historical Growth Trends in Banks' Non-Interest Income



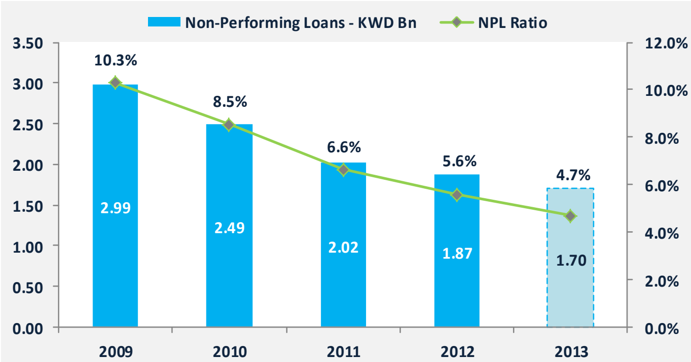
Source: Companies' Financials and KAMCO Research

Soundness of the Banking System

Significant improvement in Non-performing Loans, NPL Ratios, and Coverage Ratios:

System-wide asset quality indicators have seen gradual improvement over the period 2010-2013, after nearing the worst point of the cycle when non-performing loans reached a high of KWD 3 billion on an aggregate level for Kuwaiti Banks. Over the last four-year period, the size of non-performing loans dropped significantly by around 43% to reach around KWD 1.70 billion by the end of 2013. Accordingly, banks' the ratio of banks' NPLs to gross loans considerably improved to 4.7% at end-2013, down from its peak in 2009 of 10.3%, yet still somehow below its GCC benchmark NPL ratio of around 3.8% at the end of 2013.

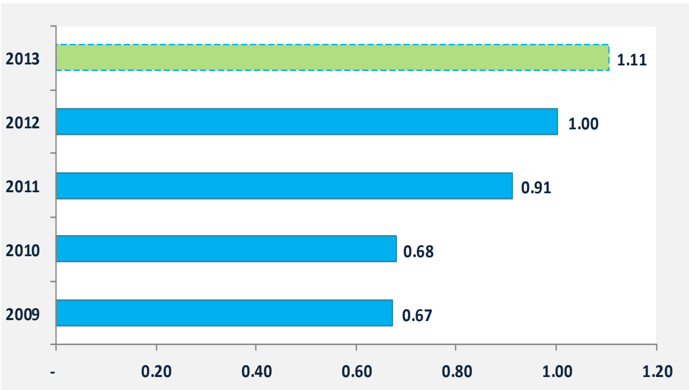
Quality of Loan Portfolio 2009 - 2013



Source: Companies' Financials and KAMCO Research

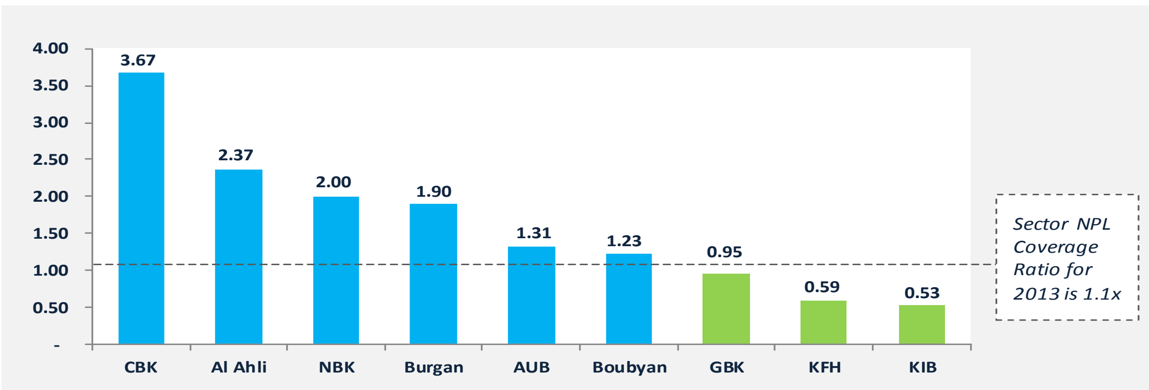
In terms of loan-loss coverage, and as banks strived to maintain a high level of precautionary reserve against the bounce in NPLs and the high risk of default, the Kuwaiti banks managed to improve their coverage of NPLs over the last 3 years to reach 111% by the end of 2013. Moreover, it worth highlighting that Kuwait has currently the second highest NPL ratio after Saudi Arabia of 156%, and above the Aggregate GCC banks' NPL coverage of around 99% at end-2013. On an individual level, the majority of the Kuwaiti banks have currently a high level of NPL coverage ratio, apart from Kuwait Finance House and Kuwait International Bank with a ratio of 59% and 53%, respectively, well below the sector average. As for Gulf Bank, the loan-loss coverage is almost close to the 100% level, yet it worth mentioning that the bank was able to improve the ratio from a low of 36% in 2010 to 95% in 2013.

Coverage ratio of the Aggregate Banking Sector 2009 - 2013



Source: Companies' Financials and KAMCO Research

NPL Coverage Ratio By Individual Bank - 2013



Source: Companies' Financials and KAMCO Research

Kuwait Banking Sector - 9M 2014 Results

Balance Sheet Size

Kuwait Banking sector total assets stood at KWD 64.7 Bn as of Sep-2014, recording a growth of 10.9% as compared to year-end 2013 asset size. The growth is mainly coming from NBK and KFH with together added KWD 4.9 Bn or around three-quarter of the growth in the sector's growth. Similarly, total liabilities grew 11.7% to stand at KWD 58.9 Bn, whereas total equity added 4.1% to reach around KWD 7.2 Bn as of Sep-2014.

Amounts in KWD Mn	Total Assets		Equity		Liabilities	
	9M-2013	9M-2014	9M-2013	9M-2014	9M-2013	9M-2014
NBK	18,956	21,731	2,464	2,592	16,293	18,923
Kuwait Finance House	14,687	17,099	1,725	1,768	12,724	15,048
Gulf Bank	5,063	5,192	475	509	4,588	4,683
Commercial Bank of Kuwait	3,886	3,893	551	578	3,334	3,314
Al Ahli Bank of Kuwait	3,048	3,543	534	551	2,514	2,992
AUB - Kuwait (BKME)	3,080	3,620	300	320	2,766	3,286
Kuwait International Bank	1,414	1,604	220	229	1,190	1,372
Burgan Bank	6,513	7,483	476	553	5,902	6,637
Boubyan Bank	2,106	2,511	258	287	1,846	2,219
Warba	387	507	91	92	296	415
Total	***59,139***	***67,183***	***7,094***	***7,479***	***51,454***	***58,890***

Source: Companies' Financials

Sector Operating and Bottom Line Results

In terms of the Sector profitability, overall operating income before loan-loss provisions grew by a marginal 0.7% for the 9M-2014 period to record KWD 1.67 Bn, while Net profit showed an increase of 18.9% for the same period to record KWD 491 Mn compared to KWD 413 Mn for the last comparable period. This improved profitability mainly owes to lower amount of provision expenses by banks for the nine-month period of 2014.

Amounts in KWD Mn	Operating Income		Net Profit	
	9M-2013	9M-2014	9M-2013	9M-2014
NBK	467	499	199	204
Kuwait Finance House	529	475	89	90
Gulf Bank	124	120	24	27
Commercial Bank of Kuwait	98	100	8	25
Al Ahli Bank of Kuwait	88	88	25	27
AUB - Kuwait (BKME)	74	78	35	39
Kuwait International Bank	42	42	9	10
Burgan Bank	187	201	18	49
Boubyan Bank	49	58	9	20
Warba	8	13	3	0
Total	***1,664***	***1,676***	***413***	***491***

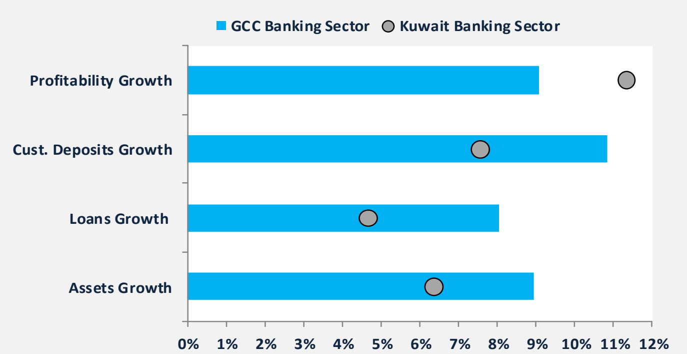
Source: Companies' Financials

GCC Banking Sector

Sector's Growth & Performance Assessment Relative to GCC Benchmark

Kuwait Banking System Growth Lagging behind GCC overall benchmark

5-year CAGR of Key Figures for Kuwait vs. GCC Benchmark

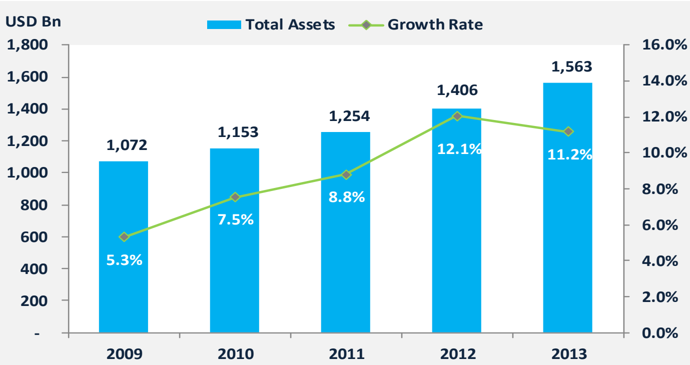


Source: Bloomberg, Companies' Financials and KAMCO Research

As compared to GCC banking sector overall performance over the last five years, Kuwait had the lowest growth rates by all standards except that profitability growth level during that period showed above sector growth, owing to the huge recovery in Net Profit during 2009-2010, when the performance of its GCC peers was still in the negative territory. However, over the last 3-year period, Kuwait banking sector's Net Profit dropped by an average of 2.6%, while the growth in overall GCC banking sector was around 13.7%. Similarly, with reference to the sector size and funding base, the growth in overall Kuwaiti banks' loan portfolio and deposit base lagged behind that of the GCC benchmark over the same period to grow by a 5-year average rate of 4.8% & 7.4%, respectively, compared to a growth of 8% and 10.8% for the GCC banks.

Size of the GCC Banking Sector

GCC Banks Total Assets and Growth

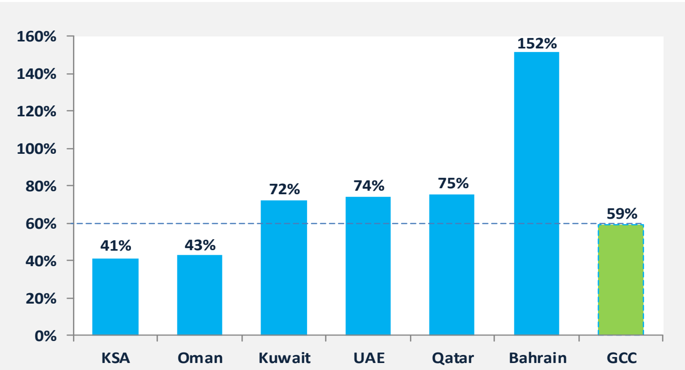


Source: Bloomberg, Companies' Financials and KAMCO Research

Growth in aggregate total assets of the GCC banking sector has been on the upside since 2009, to register a CAGR of 9% over the period 200-2013 and stand at USD 1.56 trillion by the end of Dec-2013. Assets growth is still far below the historical average of around 28% over the 2004-2008 period, owing to the sluggish growth in the loans portfolio as well as the high level of reserve for NPLs and the mark-market of the trading portfolio.

Penetration Rate: Loans to GDP

Loans to GDP Ratio of GCC Banking Sector - 2013



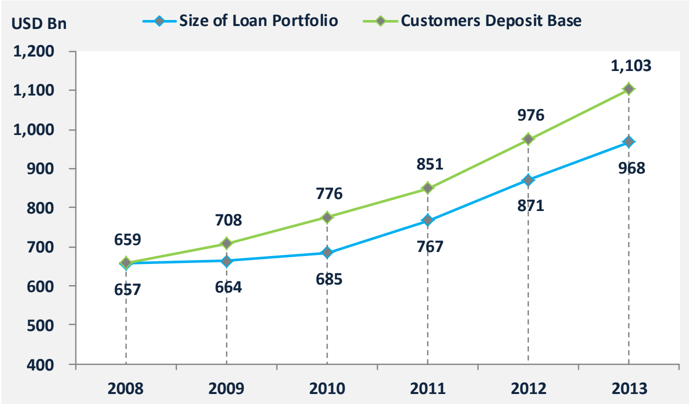
Source: Bloomberg, IMF and KAMCO Research

GCC banks' has low level of credit penetration rate with a loan to GDP ratio of 59% as of Dec-2013, which gives an indication of a high long-term growth potential as credit and default risk revert back to normal levels. On a country level, Saudi and Oman banking sectors have the lowest credit penetration rates as compared to other GCC peers and to overall GCC banking sector, whereas Bahrain has the highest rate of 152% as of 2013.

Sector's Loans Portfolio, Deposits and Market Share by Country

GCC Banks' deposit base has grown by a compounded annual growth of 10.8% over the period 2008-2013 to currently stand at USD 1.1 trillion. However, given the overall economic conditions prevailing during that period accompanied by a rising risk of default and a high level of non-performing loans, banks have adopted a more stringent lending measures in order to avoid further deterioration in the Banks' asset quality; as a result, aggregate size of GCC Banks' loan portfolio grew by a lower rate compared to deposits, or by a compounded annual growth of 8% over the same period. Therefore, implying a decline in loans to deposit ratio and hence improved liquidity.

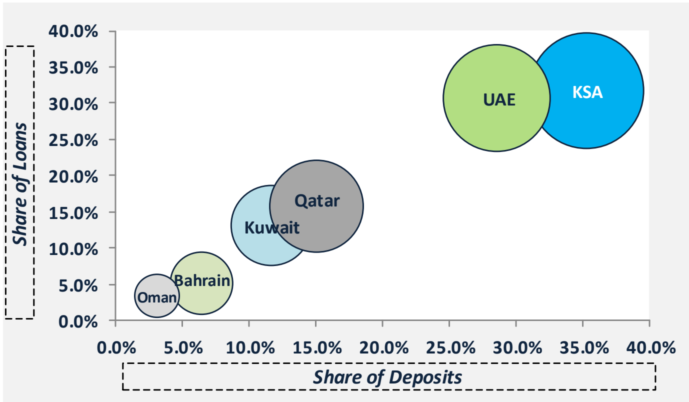
Evolution in GCC Banks' Loans & Deposits



Source: Bloomberg, Companies' Financials and KAMCO Research

In terms of market share of loans and deposits by country, the concentration remains with Saudi and UAE Banks which represent the major players in the industry and together corresponds to around 63% of the sector's aggregate loan portfolio and 64% of the customer deposit base. On the other hand, the size of the banking sector in Qatar & Kuwait comes in the 3rd & 4th place, respectively, having a combined market share of 29% & 28% in term of loans & deposits.

Market Share of Loans and Deposits for GCC Countries

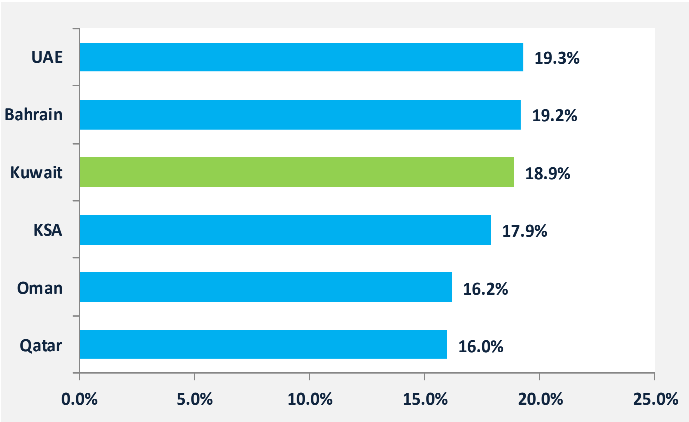


Source: Companies' Financials and KAMCO Research

Capital Adequacy of the GCC Banking Sector

GCC Banks' capitalization metrics remained healthy and steady across all countries owing to the effective and prudent regulations by the central banks in the GCC as well as to the sustainable growth rate in Banks' equity capital over the last few years. With this ample level of capitalization, GCC banks are well equipped to further expand their core operating activities and at the same time to absorb any potential shocks that might arise in the future given the current macroeconomic conditions.

2013 Capital Adequacy Level

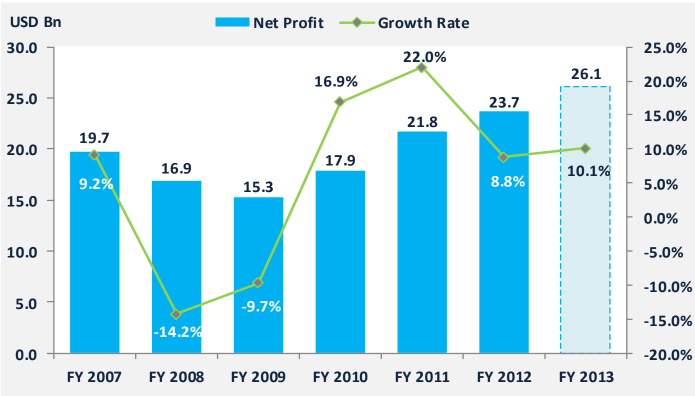


Source: IMF, Companies' Financials and KAMCO Research

GCC Banking Sector Profitability and Latest Provisions for Loan-Losses

In general, the GCC banking sector has been operating in a challenging environment, with a high level of provisions and impairments. Net profit for the sector reached a low of USD 15.3 billion in 2009, to then start its recovery by posting healthy growth rates . It was only in 2011 when the sector total profit exceeded the highest level recorded in 2007. Over the last four years, Net Profit grew by an average rate of 14.5% to currently stand at USD 26.1 billion. Nevertheless, the average growth rate is still below the outstanding historical levels owing to the weak economic conditions prevailing in the global as well as regional markets.

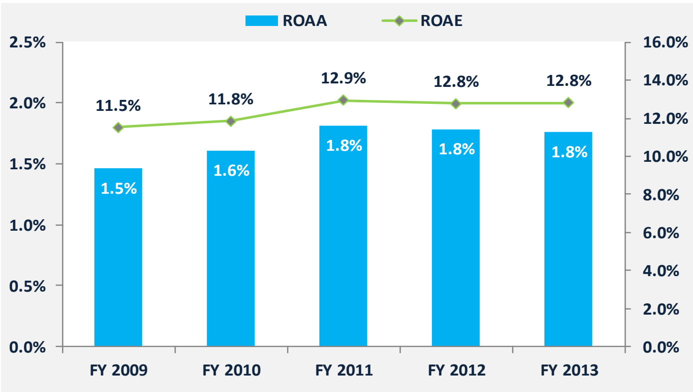
Total Net Profit for GCC Banking Sector



Source: Bloomberg, Companies' Financials and KAMCO Research

On the other hand, GCC overall banks' core profitability ratios, return on average assets and return on average equity have stabilized at around 1.8% and 12.8%, respectively, over the last three-year period after showing a marginal recovery from their lowest levels of 1.5% and 11.5% in FY-2009. ROAA and ROAE are still way below the pre-crisis outstanding historical average seen of around 2.9% and 22.5% for the 2004-2008 period.

Core Profitability Measure for GCC Banks



Source: Bloomberg, Companies' Financials and KAMCO Research

Return on asset and return on equity for the banking system in the GCC region have shown some volatility in some countries as banks increased their capital to maintain a certain adequacy level, while net income was still pressured by the high amount of provisioning. On a country basis, Qatar and Saudi Arabia have the highest levels of return on asset and return on equity and well above the GCC overall average; whereas, Kuwait and Bahrain both have below GCC benchmark average.

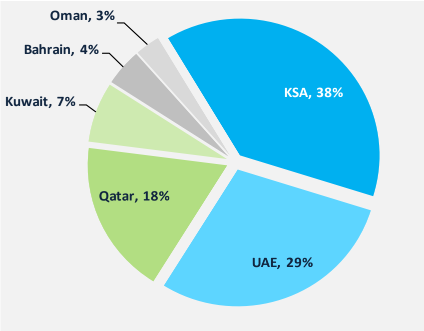
ROAA	FY 2010	FY 2011	FY 2012	FY 2013
Qatar	2.8%	2.8%	2.4%	2.2%
KSA	2.0%	2.2%	2.2%	2.1%
Oman	1.7%	1.5%	1.6%	1.7%
UAE	1.3%	1.5%	1.6%	1.7%
Kuwait	1.3%	1.2%	1.1%	1.0%
Bahrain	0.1%	1.0%	0.8%	1.0%
GCC Overall	**1.6%**	**1.8%**	**1.8%**	**1.8%**

ROAE	FY 2010	FY 2011	FY 2012	FY 2013
Qatar	18.3%	17.7%	15.6%	15.2%
KSA	14.1%	14.9%	15.1%	14.9%
Oman	12.5%	12.2%	13.3%	13.2%
UAE	10.2%	11.4%	11.8%	12.5%
Kuwait	10.4%	9.3%	8.8%	7.7%
Bahrain	1.1%	8.1%	6.2%	7.9%
GCC Total	**11.8%**	**12.9%**	**12.8%**	**12.8%**

Source: Bloomberg, Companies' Financials & KAMCO Research

With reference to each country's contribution to total profit, KSA still has the lion's share, followed by UAE and Qatar, all together generating around 85% of the sector's earnings. However, its is to be noted that the share of profit for Saudi and Kuwaiti banks have been on the decline to the favor of UAE & Qatar, whereas Bahrain & Oman's contribution is almost stable as compared to historical averages.

Country Contribution to GCC Banks Aggregate Net Profit

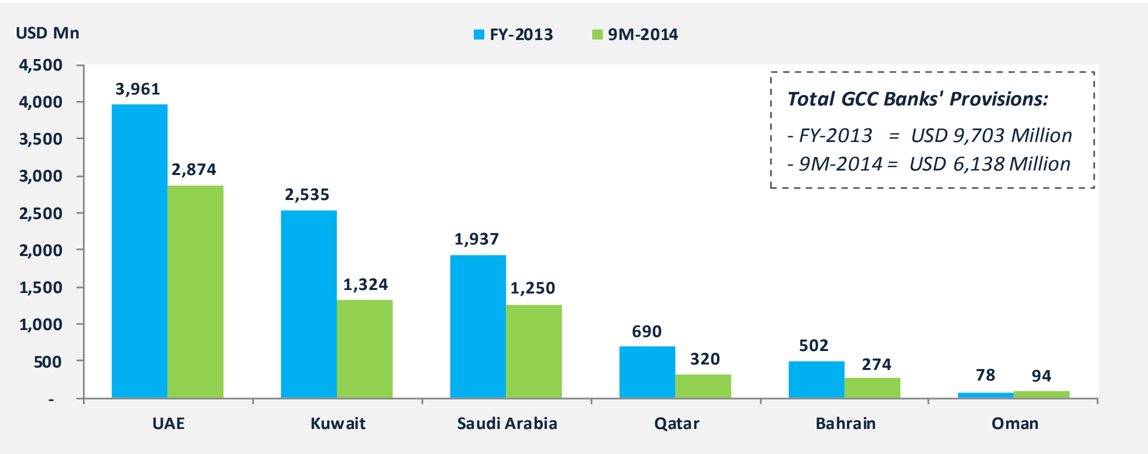


Country	2004-2008	2009-2013
KSA	48%	40%
UAE	21%	28%
Qatar	10%	18%
Kuwait	15%	9%
Bahrain	3%	2%
Oman	2%	3%
Total	100%	100%

Source: Bloomberg, Companies' Financials and KAMCO Research

Over the last few years, loan-loss provisioning expenses have consumed a significant part of banks' core revenues. As well, for the 9M-period ending 2014, loan-loss provisions are still elevated and continue to represent the largest single risk factor to the GCC banking sector earnings. The total provisions booked by GCC banks 2013 and 9M-2014 amounted to USD 9.7 billion and USD 6.1 billion, respectively. Kuwait and UAE has the highest level of Provision, both in absolute terms and relative to the size of operating income.

GCC Banking Sector's Provisions for Loan-Losses for FY-2013 and 9M-2014

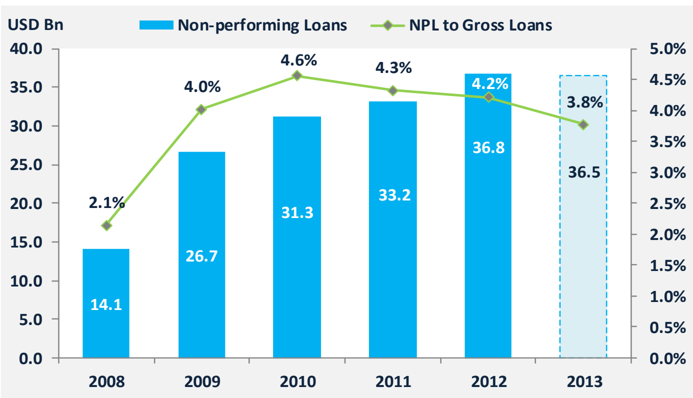


Source: Bloomberg, Companies' Financials and KAMCO Research

Improved Asset Quality and Coverage Level

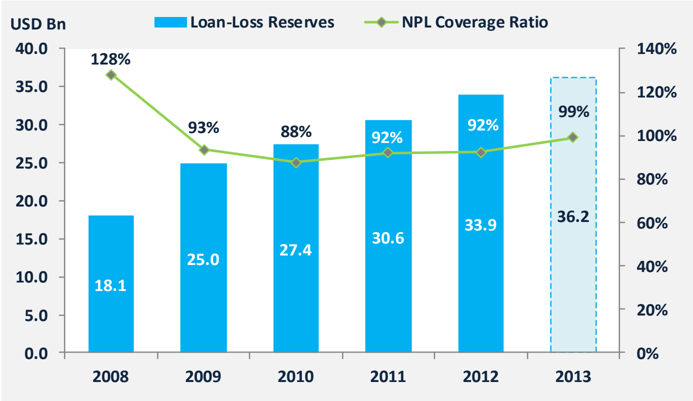
GCC banks saw the size of its no-performing loans more than doubling over the last 5-year period, jumping from USD 14.1 billion in 2008 to USD 36.5 billion in 2013. This massive increase in NPLs came on the back of the high exposure to real estate and investment sectors which suffered from huge losses during that period. Nonetheless, the NPLs ratio has shown some improvement over the last three years to currently represent around 3.8% of gross loans, down

Evolution in Non-performing Loans and NPL Ratio



Source: Bloomberg, Companies' Financials and KAMCO Research from a high of 4.6% in 2010, yet still below the historical levels. On the other hand, and in-line with the increased level of loans default, GCC banks' were forced to increase their loan-loss reserve to reach USD 36.2 billion in 2013, up from USD 18.1 billion in 2008; accordingly, NPLs coverage has show gradual improvements from 93% in 2009 to currently stand at 99%, compared to 128% in 2008.

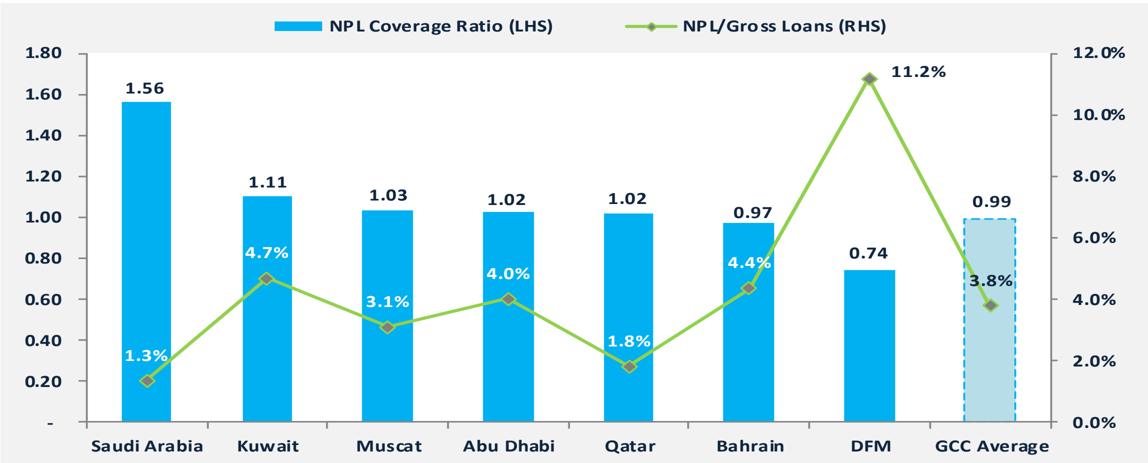
Total Reserve and Coverage Ratio



Source: Bloomberg, Companies' Financials and KAMCO Research

On a country level, the Saudi banking sector has currently the lowest ratio of non-performing loans to gross loans and at the same time enjoys the highest coverage ratio of 156%. Kuwait banking sector comes second with a coverage ratio of 111%. On the lower end comes UAE, where banks in Dubai still suffer from a high level of NPL ratio of 11.2%, way above the GCC average ratio of 3.8% and at the same time has a low coverage of 74%, as compared to 99% for overall GCC banks.

2013 Loan Quality Indicators by Country



Source: Bloomberg, Companies' Financials and KAMCO Research

KAMCO Research

December - 2014

National Bank of Kuwait

Investment Thesis

We are initiating coverage on NBK with an Outperform rating and a price target of KWD 1.006 per share representing an upside potential of 13.04% on the stock. *Our positive outlook on the Bank is well supported by the strong position within the Banking Industry as well as the prudent and well focused expansionary strategy set by the management team.*

NBK recorded a CAGR of 4.2% in NII over the last five years*, in-line with the sector's historical growth rate. On the other hand, NIM has been trending downward to reach 3.04% in 2013, down from 3.6% in 2008. We estimate the growth in NII to improve during the next 5 years to reach KWD 737 Mn by the end of 2018, growing at a CAGR of 10.3%, driven by higher lending volume as well as enhanced interest margins which we estimate to gradually improve to reach 3.11% by 2018.*

Provisions for loan losses bounced over the last two years, *however still at acceptable relative to the size of the Bank's operating income. Looking ahead, we forecast the provision expenses to remain at their highest level in 2014-2015 and then to drop gradually afterwards. However, we believe that the relative ratio of provision expenses to total operating income will drop gradually over the next five years.*

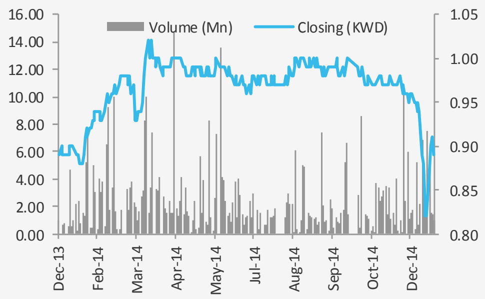
NBK maintained a high ratio of NPLs coverage ratio*, well above the sector average and among the highest as compared to its peers. Over the projected horizon, we expect the NPL ratio to drop gradually from its current level of 2% to reach 1.7% by the end of 2018. As well, we estimate the coverage ratio to head north as the bank strives to take additional precautionary reserves against potential credit defaults.*

NBK's Net Profit grew a CAGR of 4.6% over the period 2008-2013, *however 2013 profits dropped by 22% as compared to the previous year, mostly due to lower investment income. we estimate Net Profit to reach KWD 502 Mn in 2018, that is a CAGR of 16.1%. Thus, ROAA and ROAE to gradually improve to reach 1.9% and 16% in 2018.*

Key Indicators	2013	2014e	2015e	2016e	2017e	2018e
Net Interest Income (KWD Mn)	451.5	512.3	581.0	631.6	682.3	737.4
Net Profit (KWD Mn)	238.1	276.8	334.6	413.5	466.5	502.4
NPL to Gross Loans	2.0%	1.9%	1.8%	1.8%	1.8%	1.7%
NPL Coverage Ratio (X)	2.00	2.40	2.70	2.90	3.10	3.30
NIM (%)	3.04%	2.96%	2.95%	2.98%	3.04%	3.11%
Spread (%)	3.03%	2.96%	2.93%	2.95%	3.00%	3.07%
ROAA (%)	1.4%	1.4%	1.5%	1.7%	1.8%	1.9%
ROAE (%)	10.2%	11.4%	13.0%	15.1%	16.0%	16.0%
EPS (KWD)	0.053	0.059	0.071	0.088	0.099	0.107
BVP (KWD)	0.559	0.562	0.600	0.648	0.697	0.748
PE (X)	16.79	15.16	12.54	10.15	8.99	8.35
PB (X)	1.59	1.58	1.48	1.37	1.28	1.19
Yield (%)	3.37%	3.73%	4.51%	5.57%	6.28%	6.77%

Outperform

CMP 25-Dec-14	KWD 0.890
Target Price	KWD 1.006
Upside/Downside	+13.04%



Price Perf.	1M	3M	12M
Absolute	-7.3%	-9.2%	3.8%
Relative	-2.5%	2.0%	6.4%

Stock Data	
Bloomberg Ticker	NBK KK
Reuters Ticker	NBKK.KW
Last Price (KWD)	0.890
M.Cap (KWD Mn)	4,272
M.Cap (USD Mn)	14,609
52-Week Range (KWD)	1.020/0.820
52-Week ADVT (KWD Mn)	2.205

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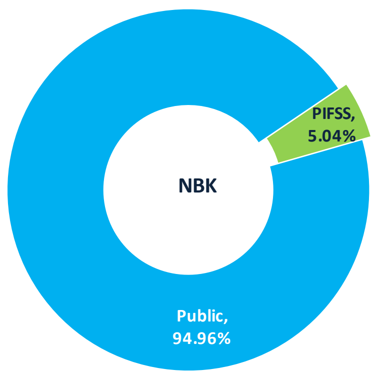
Company Overview

NBK was established in 1952 as the first local bank and the first shareholding company in Kuwait and the Gulf region. Over the years, NBK has remained the leading financial institution in Kuwait and has successfully extended its well-established franchise throughout the Middle East. NBK currently operates through a large international network covering the world's leading financial and business centers across 16 countries and has the widest banking presence with more than 170 branches worldwide.

NBK has historically acted as lead-financer for the majority of public contracts awarded to foreign companies, and the bank's size places it in a preferential position to exploit larger credit opportunities compared to its domestic peers. As well, it is one of the few local banks with the capacity to structure and underwrite large capital market transactions.

NBK's Shareholding Structure



Source: NBK Financials

Key Developments & Credit Rating Update

During 2012, NBK acquired additional equity interest of 11.1% in Boubyan Bank, therefore increasing the effective equity interest to 58.4%. Having obtained control, the Bank has reclassified the investment in Boubyan Bank form associate to subsidiary and consolidated the financials statements from 31st July, 2012.

In its latest credit opinion report released in Oct-14, Moody's Investors Service has recently affirmed NBK's Aa3/ Prime- 1 long- & short-term deposit ratings and the bank's C standalone bank financial strength rating (BFSR), equivalent to a baseline credit assessment of a3.

Moody's Investors Service said that National Bank of Kuwait's (NBK) rating, the highest in the Middle East and North Africa, reflects its dominant domestic franchise, resilient core profitability, and robust financial fundamentals including consistently good asset quality metrics and strong capitalization. Furthermore, Moody's stressed that NBK is well positioned to take advantage of new business opportunities as the Kuwaiti government's development plan begins to gain traction in 2014 with more infrastructure projects being tendered than in previous years.

Moreover, in its latest report published in May-2014, Standard & Poor's affirmed the long-term credit ratings of NBK at A+ with a stable outlook, reflecting the agency's belief that NBK's overall business and financial profile will remain resilient and generally unchanged over the next two years. The report pointed out that NBK's main rating strengths include the bank's leading commercial position in its domestic market, its strong capitalization on the back of good earning capacity, and more resilient asset quality than that of its peers.

Besides, Standard & Poor's assessed NBK's risk position as "adequate", and said "We do not foresee a deterioration of the nonperforming loan (NPL) ratio over the next few quarters. We believe that NBK's sound earnings capacity can absorb high and incremental cost of risk as it emerges."

NBK has announced in Oct-14 that it has agreed to sell its 30% stake in its Qatari associate, International Bank of Qatar (IBQ), to Qatari investors in a transaction worth USD 538 million (KWD

155 million) and generating a gain of USD 87 million (KWD 25 million) that is expected to be reflected in 2014 results. The sale is subject to customary conditions including regulatory approvals.

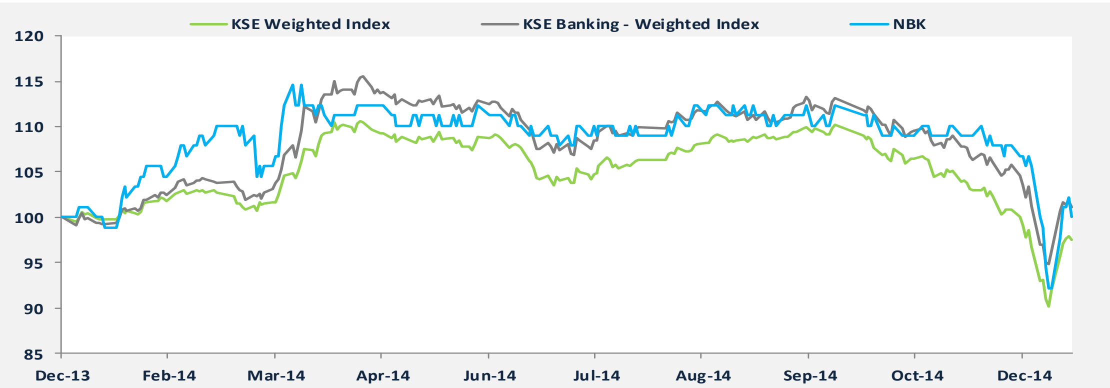
In line with NBK strategy to strengthen grow its position in the regional markets, especially the UAE and other GCC markets that offer growth opportunities, NBK has announced in March-2014 the opening of its new Head Office in Dubai.

Historical Price Performance

NBK's current share price as on 25 Dec-14 was KWD 0.890, recording a year to date increase of 8.5% (adjusted for dividends) resulting in total market capitalization of KWD 4.27 billion. During the last 52 weeks NBK's closing price reached the highest price of KWD 1.020 while the lowest during the same period was KWD 0.800. Since the listing date in 1999 NBK's price reached the highest price ever of KWD 2.480 during November 2005 before the financial crisis starts in 2008.

Based on the 9M-2014 financial results, trailing twelve month PE multiple works out to be 17.74x as compared to Kuwait Banking Sector PE of 21.52, while NBK's PB stood at 1.67x compared to 1.75x for the Kuwaiti Banking Sector. On the other hand, dividend yield stood at 3.15% above the sector dividend yield of 2.23%. The bank's beta stood at 1.48 based on the historical price for more than 5 years. The YTD-2014 capital turnover ratio recorded 11.5%.

NBK Stock Price Performance Vs. KSE Wtd index and Banking Wtd index



Source: KSE & KAMCO Research (Rebased Index 100)

Key Subsidiaries / Joint Ventures / Associates

Investment in Associates / Subsidiaries as of Dec-2013	Country	Carrying Value KWD 000's	Effective Ownership
Associates			
International Bank of Qatar Q.S.C	Qatar	137,445	30.0%
Bank Syariah Muamalat Indonesia T.B.K	Indonesia	4,975	30.5%
Bank of London and the Middle East	United Kingdom	37,785	25.6%
Turkish Bank A.S	Turkey	26,114	36.4%
United Capital Bank	Sudan	4,482	21.7%
Others	-	4,225	-
Total	**-**	**215,026**	**-**
Subsidiaries			
National Bank of Kuwait (International) plc	United Kingdom		100.0%
NBK Banque Privee (Suisse) S.A.	Switzerland		100.0%
National Bank of Kuwait (Lebanon) S.A.L	Lebanon		85.5%
National Investors Group Holding Limited	Cayman Islands		100.0%
Credit Bank of Iraq S.A.	Iraq		81.0%
Watani Investment Company K.S.C. (Closed)	Kuwait		99.9%
Watani Financial Brokerage Company K.S.C. (Closed)	Kuwait		86.7%
Al Watany Bank of Egypt S.A.E.	Egypt		98.5%
Boubyan Bank K.S.C.P	Kuwait		58.4%

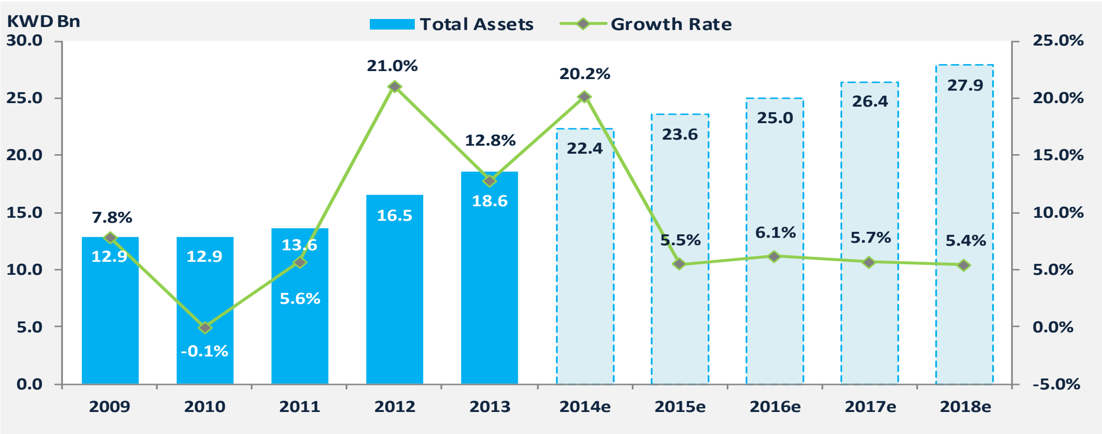
Source : KAMCO Research and National Bank of Kuwait

Asset Structure & Funding Base

Balance Sheet Size

NBK's total asset base grew at a compounded annual rate of 9.2% over the last 5-year period, exceeding the Sector growth rate of 6.3% over the same period, and stood at KWD 21.7 Bn as of Sep-2014. Such a solid growth relative to its peers, despite the sluggish economic conditions and the uncertainties in the equity market, reassures the Bank's dominant position in the market. We forecast the Bank's assets to grow at a compounded annual rate of 8.4% over the project 5-year horizon and reach KWD 27.9 Bn as of Dec-2018. Our positive outlook on the Bank is well supported by the strong position within the Banking Industry as well as the prudent and well focused expansionary strategy set by the management team.

Total Assets - Historical and Expected Growth Tends

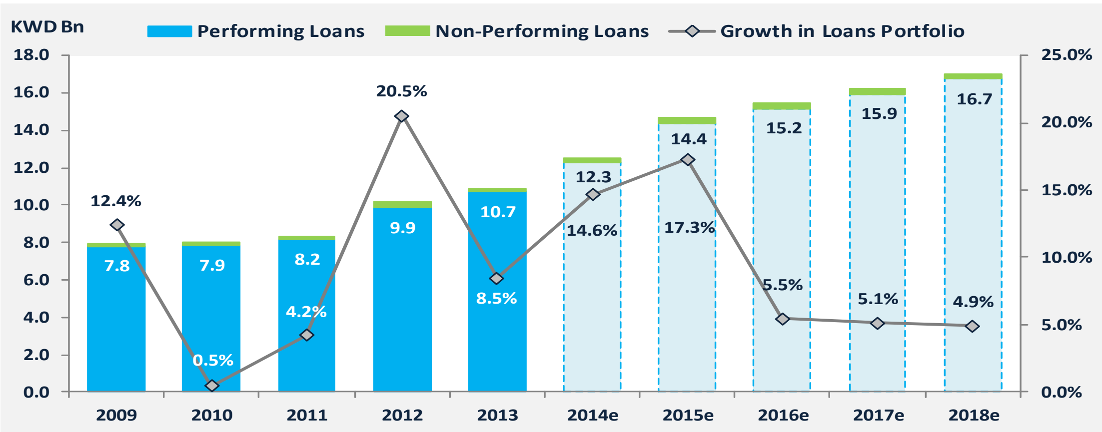


Source: NBK Financials and KAMCO Research

Size and Quality of Loans Portfolio

Over the historical period 2008-2013 and despite the slowdown in banking activities seen during 2010-2011, on the back of the financial crisis, NBK's total loans volume recorded a healthy growth of 9.1%, as compared to a growth of 4.8% for the sector, to currently stand at KWD 11.6 Bn as of Sep-2014. Going forward, and taking into account the effect of the full consolidation of Boubyan Bank, we estimate NBK' loan portfolio to grow by a compounded annual rate of 9.8% over the next 5 years and reach KWD 16.7 Bn by the end of 2018. On the other hand, we expect that the quality of loans to keep on improving gradually in line with our expectation of a recovery in the market conditions and a normalization of default risk.

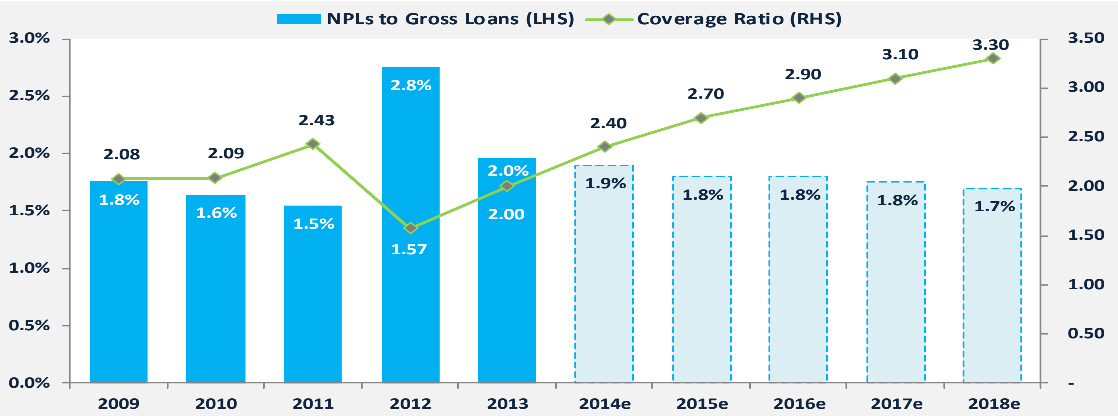
Loans Portfolio - Growth & Quality



Source: NBK Financials and KAMCO Research

NPLs to gross loans ratio stood at 1.8% by the end of 2009, when the high level of credit default during the financial crisis resulted in a bounce in the amount of NPLs which recorded KWD 142 Mn; however the NPLs ratio showed gradual improvements up till 2012 as the full consolidation of Boubyan Bank resulted in the ratio jumping again to a high of 2.8%. On the other hand, the Bank maintained a high ratio of NPLs coverage ratio, well above the sector average and among the highest as compared to its peers. Over the projected horizon, we expect the NPL ratio to drop gradually from its current level of 2% to reach 1.7% by the end of 2018, supported the strict lending policy of the bank and the high standards set by the Central Bank of Kuwait. As well, we estimate the coverage ratio to head north as the bank strives to take additional precautionary reserves against potential credit defaults.

NPLs and Coverage Ratios



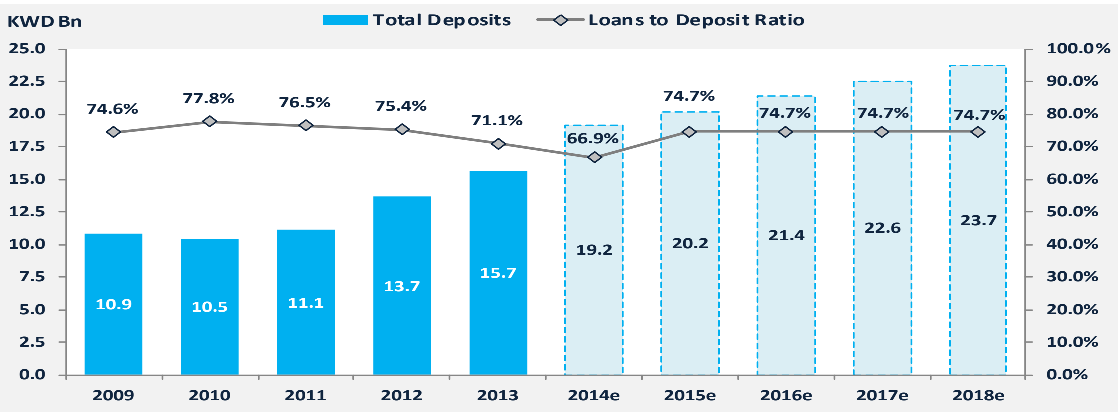
Source: NBK Financials and KAMCO Research

Funding Base and Loans to Deposit Ratio

NBK's deposit base have grown in line with the growth in loans portfolio, that is at a compounded annual rate of 9%, above sector average growth of 6.3%, and stood at KWD 18.7 Bn as of Sep-2014. We expected the growth in total deposits to keep the same pace over the next 5-years and grow by a CAGR of around 8.7%, to reach KWD 23.7 Bn by the end of 2018. On the other hand, loan-to-deposit ratio have been trending down since 2010, given the stringent lending policies across the sector, and stood at 71.1% as of Dec-2013. Going forward, we estimate the ratio to revert back to historical average of around 74.7%. The forecasted ratio of loan-to-deposit is mainly based on the maturity profile of the Bank's funding base and the lending ratio set by the Central Bank of Kuwait for each bracket according to maturity.

Customer deposits, the major constituent of the Bank's funding base and its key growth driver, recorded a double digit growth of 14.1% over the historical period, fairly above the sector growth of 7.4%. We estimate customer deposits to growth by a 5-CAGR of 8.2% to reach KWD 15.8 Bn by Dec-18.

Total Deposit Base & Loans-to-Deposits Ratio

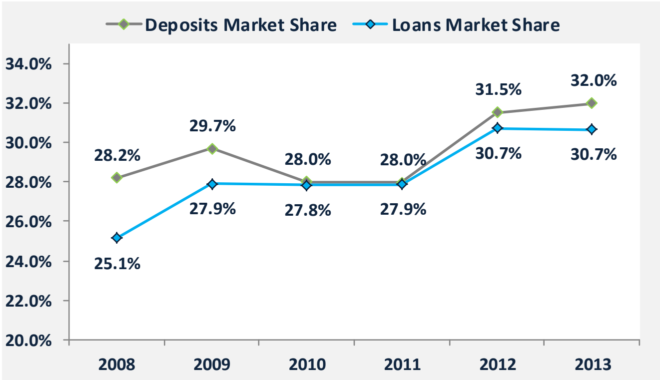


Source: NBK Financials and KAMCO Research

Market Share of Loans & Deposits

The market share of NBK's loans portfolio has increased from 25.1% in 2008 to 30.7% in 2013, with the big jump in 2012 upon the acquisition of a controlling stake in Boubyan Bank. Similarly, market share of deposit have followed the same trend to reach 32% in 2013, up from 28.2% in 2008. We forecast NBK to gain additional market share in the future as the Bank competes more in Islamic Banking through its subsidiary, Boubyan Bank.

Market Share of Loans & Deposits

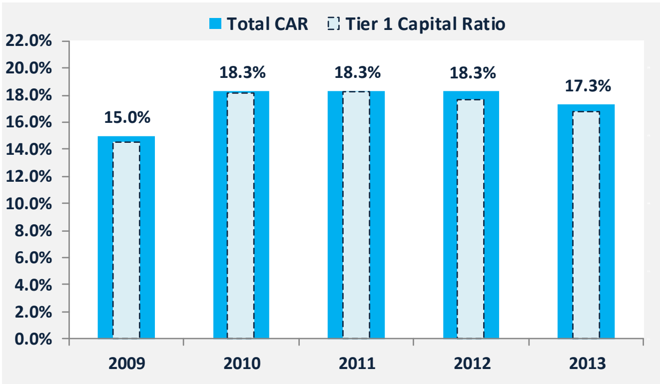


Source: NBK Financials and KAMCO Research

Equity and Capital Adequacy

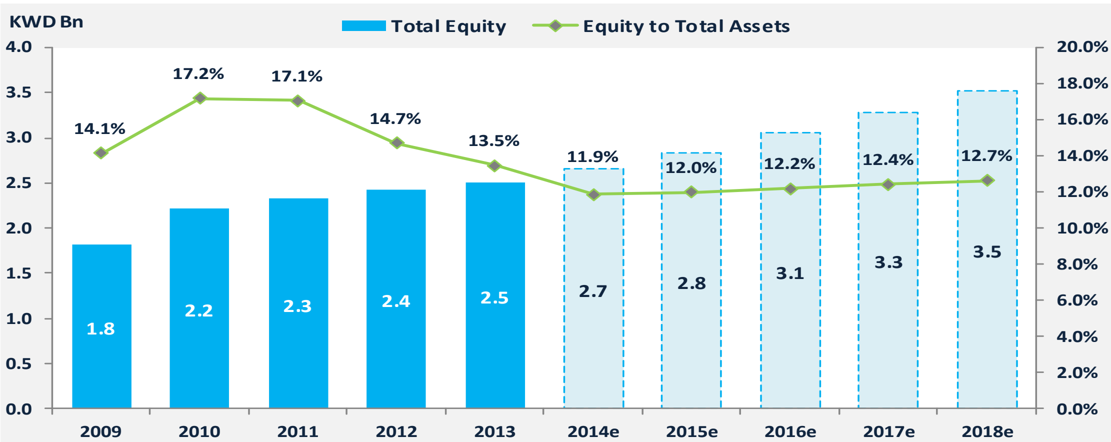
NBK enjoys a high level of capital adequacy with the total CAR standing at 17.3% as of Dec-2013. As well, the Bank has maintained a solid equity base with the equity-to-asset ratio at around 13.5%, relatively above the sector average of 12.3% as of Dec-2013. We forecast the Bank to maintain a high level of equity capital over the forecasted period, fairly above the minimum requirements set by the Central Bank of Kuwait.

Capital Adequacy Ratios



Source: NBK Financials and KAMCO Research

Shareholders' Equity



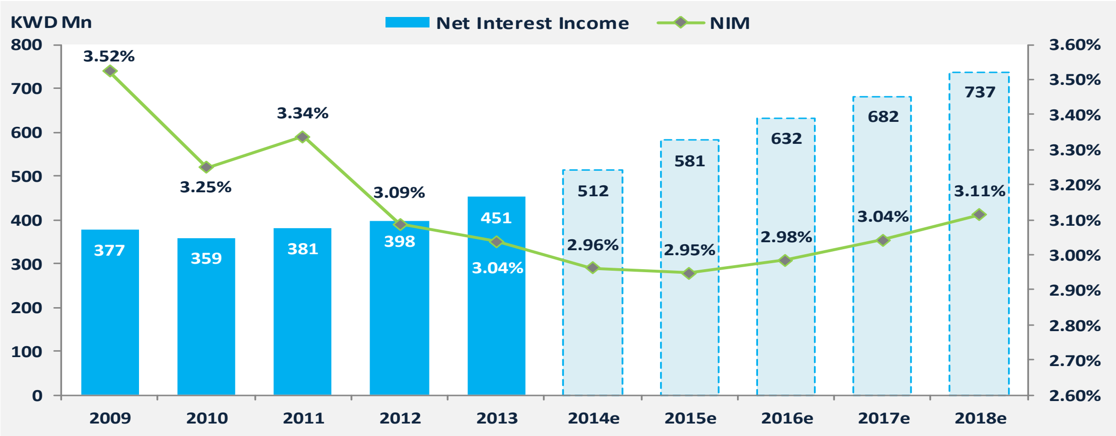
Source: NBK Financials and KAMCO Research

Profitability

Net Interest Income & Margins

Within the context of a persistently low interest rate atmosphere putting pressure on interest margins along with a moderate growth in loans volume, NBK's Net Interest Income (NII) grew at a compounded rate of 4.2% over the last five years, in line with the Sector's growth. As well, Net Interest Margin (NIM) has been on the decline since the onset of the financial crisis, dropping from a high of 3.6% in 2008, to currently stand at around 3.04%. Looking ahead, we estimate the growth in NII to pick-up over the next five years to reach KWD 737 Mn by the end of 2018, which is a CAGR of 10.3%. The growth in NII will be driven by higher lending volume as well as enhanced NIM which we estimate to show gradual yet slight improvements to reach 3.11% by 2018.

Net Interest Income & Margins

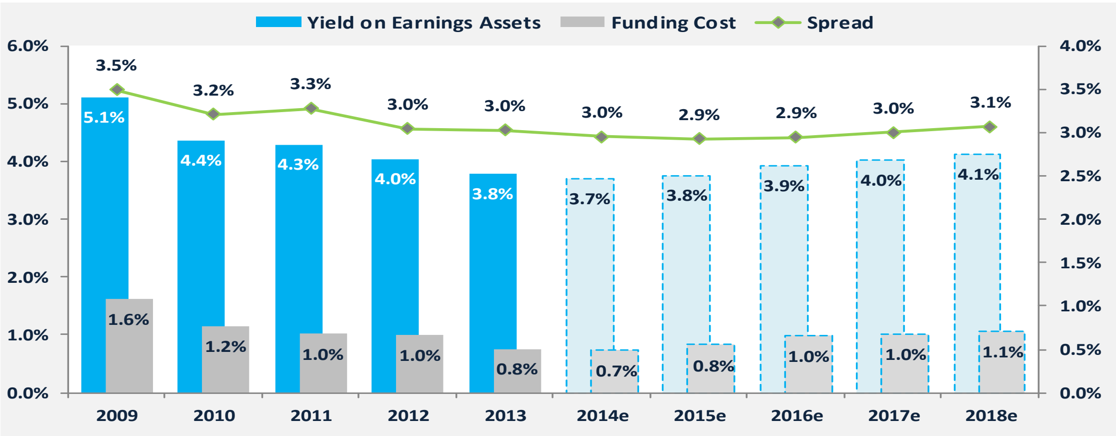


Source: NBK Financials and KAMCO Research

Moreover, interest spread followed the same declining trend to reach 3% in 2013 down from a high of 3.6% in 2008, as the drop in interest rates had a greater impact on the yield on earnings assets than on the funding cost, with the latter currently standing at a near to the ground level of 0.8%, down from 3.2% in 2008, or around 245 bps; whereas yield on earnings assets dropped by a significant 299 bps over the same period.

Over the next five years, we expected the interest rate to show slight improvement over the next five years, accordingly positively affecting the yield on earnings assets and therefore resulting in higher interest spreads and margins.

Major Profitability Margins

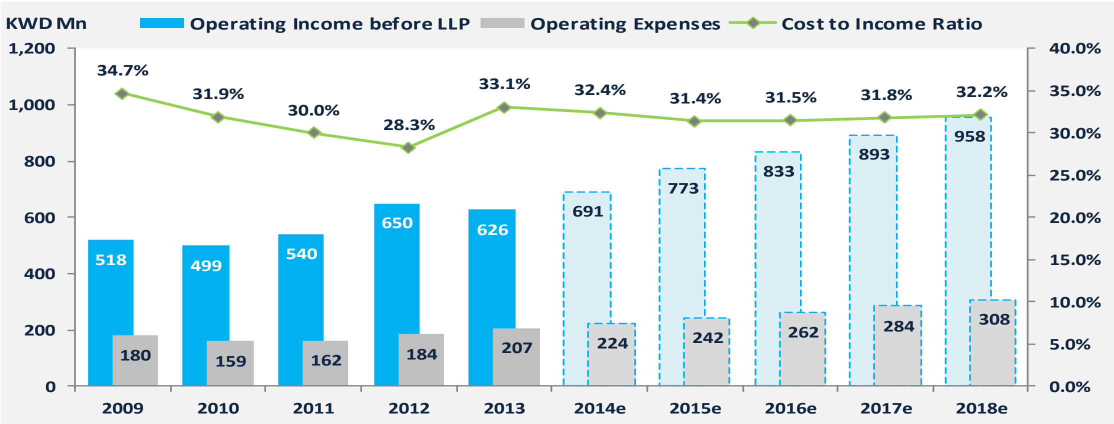


Source: NBK Financials and KAMCO Research

Operating Income and Provisions for Loan Losses

Amid the passive economic conditions experienced over the last five years across all economies, NBK's total operating income grew at a compounded annual rate of 4.3% compared to a growth of 3.9% for the sector, to stand at KWD 626 Mn for FY 2013. This marginal growth in operating income is fairly below the double digit growth seen during the period before the financial crisis mainly due to lower brokerage activities, lower investment income as well as lower growth in core business activities. However, the 9M-2014 results showed an improved growth in operating income which recorded KWD 499 Mn, an increase of 6.9% compared to 9M-2013 results, and way above the sector's growth of 0.7% for the same period. On the other hand, NBK's operating expenses increased at a CAGR of 5.4% in the middle of an increasingly inflationary cost environment and in line with banks' expansionary strategies. Accordingly, cost to income ratio has increased from 31.4% in 2008 to reach 33.1% in 2013, yet still fairly below the sector average ratio of 43.1% in 2013.

Operating Efficiency



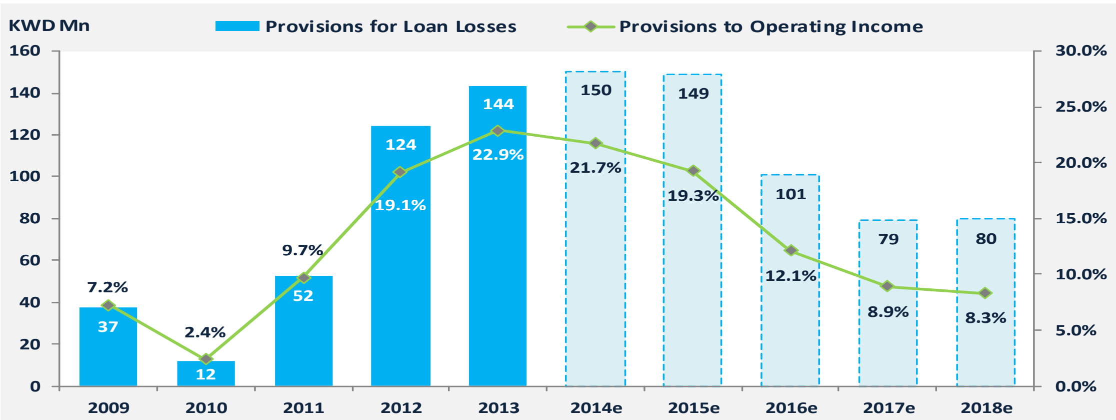
Source: NBK Financials and KAMCO Research

Looking ahead, we forecast operating income to grow at a compounded annual rate of 8.9%, mainly driven by the expected increase in spreads and margins and a gradual recovery in equity markets; while we assume a CAGR of 8.3% in operating expenses which takes into account the Bank's expansionary strategy and the expected inflation level over the next 5 years.

Provisions for Loan Losses

Provisions reserve represented the main concern for all banks after the financial crisis back in 2008, yet despite the high level of reserve that the NBK enjoys, the bank kept on booking additional specific and general provision in order to maintain a high coverage ratio.

Operating Income & Provisions for Loan Losses



Source: NBK Financials and KAMCO Research

In this context, however, the amount of provisions taken by NBK was low relative to the size of the Bank's operating income, while Loan-loss provisioning expenses booked by the Kuwaiti banks consumed around one-third of the sector's total operating income. However, over the last two years, provisions expense taken by NBK jumped significantly, due the bounce seen in non-performing loans in 2011 and as the bank strive to maintain a high coverage ratio.

Looking ahead, we forecast the provision expenses to remain at their highest level in 2014-2015 and then to drop gradually afterwards. However, we believe that the relative ratio of provision expenses to total operating income will drop gradually over the next five years.

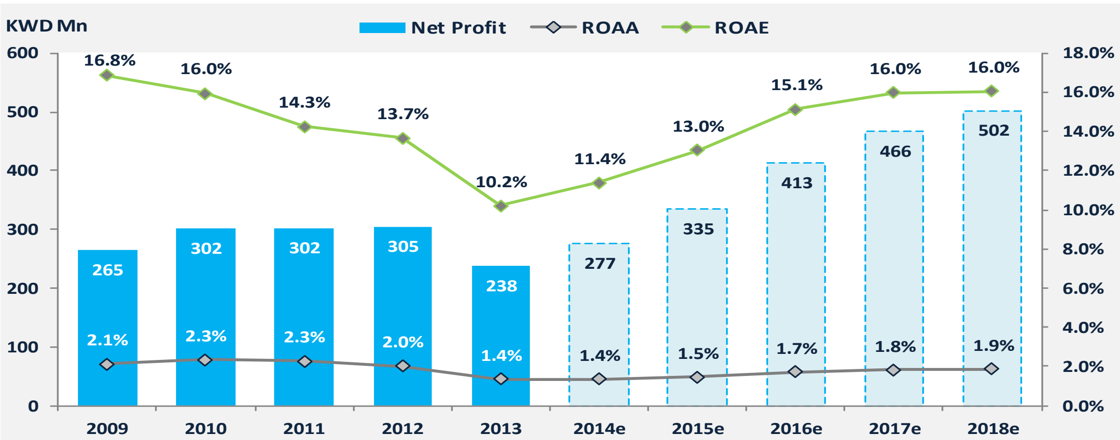
Bottom Line Results & Key Profitability Ratios

The challenging operating environment and the high level of provisions and impairments have put pressure on bottom line results. NBK's Net Profit grew a CAGR of 4.6% over the period 2008-2013, however 2013 profits dropped by 22% as compared to the previous year, mostly due to lower investment income. However, the 9M-2014 results showed an increase of 2.7% in Net Profit as compared to last comparable period, to record KWD 204 Mn.

Moreover, the banks' core profitability ratios, ROAA and ROAE have been on the decline to reach 1.4% and 10.2%, respectively, in 2013 and average around 2% and 14.2% over the last 5-year period, fairly above the sector average ratios of 1.1% and 8.7% over the same period, respectively.

Going forward, we estimate Net Profit to reach KWD 502 Mn in 2018, that is a CAGR of 16.1%. Therefore, we forecast both ROAA and ROAE to gradually improve to reach 1.9% and 16% in 2018.

Net Income & Key Profitability Measures

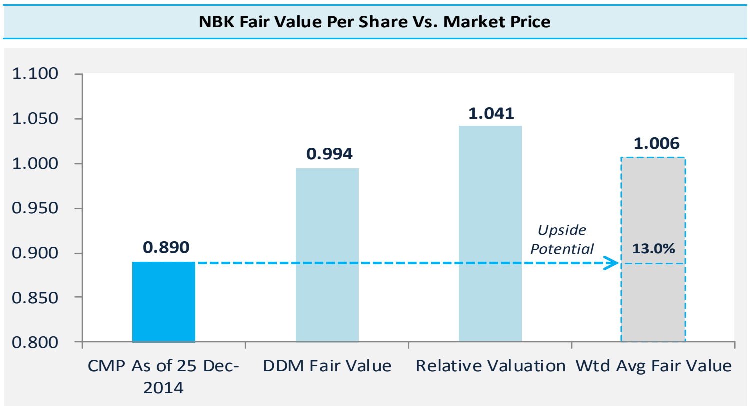


Source: NBK Financials and KAMCO Research

Valuation & Recommendation

"Outperform" rating with a Price Target of KWD 1.006 representing an upside of 13.04%

We have valued the Bank using Dividend Discount Model (DDM) and relative valuation based on Price to Book Value Multiple. We have assigned 75% weight to the DDM-based valuation and 25% weight to the relative valuation in order to arrive at an estimated fair value of KWD 1.006 per share.



Valuation Method			
	Value KWD	Weight (%)	Weighted Value KWD
DDM Fair Value Per Share	0.994	75%	0.746
Relative Valuation Per Share	1.041	25%	0.260
Weighted Average Fair Value per Share			**1.006**
Current Market Price			0.890
Upside/Downside			***13.0%***

Discounted Cash Flow Model

Our DDM valuation method is based on explicit forecast of dividend payments for the next five fiscal years (2014e-2018e) and a terminal value afterward based on a target price to book value multiple. Our discount factor is based on a modified Capital Asset Pricing Model which takes into account various risk premiums pertaining to equity market risk, company specific risk, as well as industry related risk factors on top of the risk free rate. The forecasted dividends over the projected horizon are discounted back using a cost of equity of 11.01%. We assumed a terminal growth rate of 3.0% in computing the terminal value considering the long-term growth in the economy and its impact on the sector and the Bank.

DDM Valuation	Fair Value of Equity (KWD Mn)	Fair Value Per Share (KWD)
Present Value of Dividends	873	0.185
Present Value of Terminal Value	3,812	0.809
Equity Fair Value	**4,685**	**0.994**

Based on the aforementioned methodology and assumptions, we arrived at an estimated fair value for NBK's equity at KWD 4.685 Bn, which, considering 4.71 Bn outstanding shares, translates to per share fair value price of KWD 0.994.

Sensitivity Analysis

The sensitivity analysis for the change in fair value share price to the changes in cost of equity and the terminal growth rate is mentioned in the below table.

Price Sensitivity based on DDM Model

		Cost of Equity						
		9.5%	**10.0%**	**10.5%**	**11.0%**	**11.5%**	**12.0%**	**12.5%**
Terminal Growth Rate	**2.00%**	1.175	1.094	1.022	0.958	0.903	0.852	0.806
	2.25%	1.191	1.107	1.033	0.966	0.909	0.857	0.810
	2.50%	1.209	1.121	1.044	0.975	0.916	0.863	0.815
	2.75%	1.228	1.136	1.056	0.984	0.924	0.869	0.819
	3.00%	1.248	1.152	1.068	**0.994**	0.932	0.875	0.824
	3.25%	1.270	1.169	1.082	1.005	0.940	0.882	0.829
	3.50%	1.294	1.187	1.096	1.016	0.949	0.888	0.835
	3.75%	1.320	1.207	1.112	1.028	0.959	0.896	0.841
	4.00%	1.348	1.229	1.129	1.041	0.969	0.904	0.847

Relative Valuation

For peer-based valuation, we have used the forward price to book value based on the 2015 expected Net Profit and the current market capitalization, which resulted in relative share price of KWD 1.041, based solely on the relative valuation.

Company	Country	M.Cap USD Mn	PE (x) 2015e	PB (x) 2015e
Qatar National Bank	Qatar	40,734	12.64	2.26
National Commercial Bank	Saudi	31,739	15.03	2.41
Al Rajhi Bank	Saudi	23,659	11.00	1.98
First Gulf Bank	UAE	17,944	10.91	2.01
National Bank of Kuwait	Kuwait	14,923	10.83	1.62
National Bank of Abu Dhabi	UAE	17,343	11.04	1.64
Saudi British Bank	Saudi	14,951	12.25	1.93
Riyad Bank	Saudi	14,253	11.38	1.42
SAMBA	Saudi	13,112	9.63	1.21
Kuwait Finance House	Kuwait	11,100	14.62	1.62
Emirates NBD	UAE	13,013	8.14	1.16
Abu Dhabi Commercial Bank	UAE	11,136	9.35	1.64
Arab National Bank	Saudi	8,293	10.38	1.34
Burgan Bank	Kuwait	3,234	9.77	1.60
Commercial Bank of Kuwait	Kuwait	2,943	11.50	1.35
Bank Muscat	Oman	3,492	7.38	0.91
		241,870	**11.34**	**1.73**

Source: KAMCO Researech & Bloomberg

Recommendation

Based on our valuation, the Bank is currently trading at a 11.5% discount to our weighted average fair value estimate indicating an "**Outperform**" rating following KAMCO's recommendation scale and a price target of KWD 1.006 per share representing an upside potential of 13.04% on the stock.

Financial Indicators

Balance Sheet (KWD Mn)	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Assets								
Cash and Cash Equivalents	1,271	1,611	2,412	3,367	2,521	2,782	3,034	3,335
Net Loans & Advances	8,182	9,861	10,695	12,261	14,381	15,168	15,946	16,730
Investment Securities	1,503	1,577	2,350	2,486	2,617	2,771	2,919	3,069
Investment in Associates	528	213	260	260	263	265	268	270
Other Assets	2,142	3,231	2,883	3,979	3,791	4,034	4,268	4,463
Total assets	**13,627**	**16,492**	**18,600**	**22,354**	**23,573**	**25,020**	**26,436**	**27,867**
Liabilities								
Customer Deposits	6,799	9,508	10,478	11,302	12,319	13,366	14,369	15,375
Other Liabilities	4,491	4,369	5,410	8,185	8,195	8,353	8,515	8,680
Total liabilities	**11,290**	**13,876**	**15,888**	**19,487**	**20,514**	**21,719**	**22,884**	**24,054**
Shareholders' Equity								
Share capital	396	435	457	480	480	480	480	480
Share premium	700	700	700	700	700	700	700	700
Retained Earnings	730	864	934	1,043	1,189	1,369	1,572	1,790
Other Reserves	499	427	418	428	461	505	535	556
Total Shareholders Equity	**2,325**	**2,427**	**2,509**	**2,651**	**2,829**	**3,054**	**3,287**	**3,526**
Minority Interest	12	189	203	215	229	246	266	287
Total liabilities and equity	**13,627**	**16,492**	**18,600**	**22,354**	**23,573**	**25,020**	**26,436**	**27,867**

Income Statement (KWD Mn)	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Interest & Financing Income	490	521	563	641	741	831	901	976
Interest & Financing Expenses	(109)	(123)	(112)	(128)	(160)	(199)	(219)	(239)
Net Interest & Financing Income	**381**	**398**	**451**	**512**	**581**	**632**	**682**	**737**
Net Fees & Commission Income	104	103	111	117	124	130	136	143
Investment Income	14	110	19	20	24	25	26	28
Other Income	41	39	45	42	44	46	48	50
Total Non-Interest Income	**159**	**252**	**175**	**179**	**192**	**201**	**211**	**220**
Total Operating Income	**540**	**650**	**626**	**691**	**773**	**833**	**893**	**958**
Provisions Expenses & Impairments	(57)	(139)	(149)	(158)	(157)	(109)	(88)	(89)
Operating Expenses	(162)	(184)	(207)	(224)	(242)	(262)	(284)	(308)
Profit before Taxation & Minority Interest	**321**	**327**	**270**	**310**	**374**	**462**	**521**	**561**
Taxation	(17)	(19)	(19)	(21)	(25)	(31)	(35)	(38)
Minority Interest	(1)	(3)	(13)	(12)	(14)	(17)	(19)	(21)
Net Profit Attributable to Shareholders	**302**	**305**	**238**	**277**	**335**	**413**	**466**	**502**
EPS (KWD)	**0.070**	**0.068**	**0.053**	**0.059**	**0.071**	**0.088**	**0.099**	**0.107**

Cash Flow (KWD Mn)	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Net Cash From Operating Activities	499	466	1,781	1,224	(567)	595	625	703
Net Cash (used in) from Investing Activities	(212)	82	(811)	(135)	(123)	(145)	(139)	(139)
Net Cash (used in) from Financing Activities	(166)	(205)	(131)	(134)	(156)	(189)	(234)	(264)
Net Change in Cash & Short-term Funds	99	340	801	955	(846)	261	253	300
Net Cash at end of the year	**1,271**	**1,611**	**2,412**	**3,367**	**2,521**	**2,782**	**3,034**	**3,335**

Source : KAMCO Research and National Bank of Kuwait

Key Financial Ratios

Key Ratios	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Profitability Ratios								
Return on Average Assets	2.3%	2.0%	1.4%	1.4%	1.5%	1.7%	1.8%	1.9%
Return on Average Equity	14.3%	13.7%	10.2%	11.4%	13.0%	15.1%	16.0%	16.0%
Net Interest Income/ Total Income (pre-provisions)	70.5%	61.2%	72.1%	74.1%	75.2%	75.8%	76.4%	77.0%
Fees and Commissions/ Total Op. Income	21.6%	20.2%	23.2%	21.9%	20.1%	18.0%	17.0%	16.4%
Non-Interest Income/ Total Income (pre-provisions)	29.5%	38.8%	27.9%	25.9%	24.8%	24.2%	23.6%	23.0%
Dividend Payout Ratio	51.9%	42.0%	56.5%	56.5%	56.5%	56.5%	56.5%	56.5%
Operating Profit Growth Rate (y-o-y)	0.4%	2.0%	-17.4%	14.6%	20.6%	23.6%	12.8%	7.7%
Total Provisions to Operating Profits	9.7%	19.1%	22.9%	21.7%	19.3%	12.1%	8.9%	8.3%
Margins & Spreads								
Net income/ Revenues	61.7%	58.5%	42.3%	43.2%	45.2%	49.8%	51.8%	51.5%
Operating Profit / Revenues	65.5%	62.8%	48.0%	48.4%	50.4%	55.5%	57.8%	57.4%
Interest Expense to Interest Income	22.3%	23.7%	19.8%	20.0%	21.6%	24.0%	24.3%	24.5%
Yield on Average Earnings Assets	4.29%	4.04%	3.79%	3.70%	3.76%	3.93%	4.02%	4.12%
Funding Cost	1.01%	1.00%	0.76%	0.75%	0.83%	0.98%	1.02%	1.05%
Net Spread	3.28%	3.05%	3.03%	2.96%	2.93%	2.95%	3.00%	3.07%
Net Interest Margin	3.34%	3.09%	3.04%	2.96%	2.95%	2.98%	3.04%	3.11%
Operating Efficiency Ratios								
Cost to Total Op Income	30.0%	28.3%	33.1%	32.4%	31.4%	31.5%	31.8%	32.2%
Staff Expense to Total Op. Income	16.9%	15.7%	18.4%	18.1%	17.7%	17.9%	18.3%	18.6%
Cost to Average Total Assets	1.2%	1.2%	1.2%	1.1%	1.1%	1.1%	1.1%	1.1%
Liquidity Ratios								
Net Loans to Interest Earnings Assets	70%	70%	68%	65%	70%	70%	69%	69%
Gross Loans to Customer Deposits	125%	108%	106%	114%	123%	120%	117%	115%
Gross Loans to Total Deposits	77%	75%	71%	67%	75%	75%	75%	75%
Gross Loans to Total Assets	62%	62%	60%	57%	64%	64%	64%	64%
Due from Banks to Due to Banks	18%	29%	18%	26%	20%	21%	22%	23%
Credit Quality Ratios								
Non-Performing Loans / Gross Loans	1.5%	2.8%	2.0%	1.9%	1.8%	1.8%	1.8%	1.7%
Loan-Loss Reserve / Gross Loans	3.8%	4.3%	3.9%	4.6%	4.9%	5.2%	5.4%	5.6%
Loan-Loss Reserve / Non-perofrming Loans (Coverage)	2.43	1.57	2.00	2.40	2.70	2.90	3.10	3.30
Loan-Loss Provision / Total Op. Income	10.8%	24.3%	30.1%	28.2%	24.2%	13.9%	9.9%	9.2%
Capital Adequacy Ratios								
Equity to Total Assets	15.9%	13.9%	12.8%	11.2%	11.2%	11.3%	11.4%	11.6%
Equity to Gross Loans	25.5%	22.3%	21.3%	19.4%	17.5%	17.6%	17.9%	18.3%
Market Data and Valuation Ratios								
Closing Share Price (KWD)	1.120	0.960	0.890	0.890	0.890	0.890	0.890	0.890
Number of Shares (Mn)	3,958	4,353	4,571	4,800	4,800	4,800	4,800	4,800
Market Capitalization (KWD Mn)	4,433	4,179	4,068	4,272	4,272	4,272	4,272	4,272
EPS (KWD)	0.070	0.068	0.053	0.059	0.071	0.088	0.099	0.107
Book Value Per Share (KWD)	0.592	0.568	0.559	0.562	0.600	0.648	0.697	0.748
Dividend Per Share (KWD)	0.040	0.030	0.030	0.033	0.040	0.050	0.056	0.060
Price to Earnings Multiple (X)	16.00	14.12	16.79	15.16	12.54	10.15	8.99	8.35
Price to Book Value Multiple (X)	1.89	1.69	1.59	1.58	1.48	1.37	1.28	1.19
Dividend Yield (%)	3.6%	3.1%	3.4%	3.7%	4.5%	5.6%	6.3%	6.8%

Source : KAMCO Research and National Bank of Kuwait

Note : Forward Valuation ratios are based on current market prices

Kuwait Finance House

Neutral

CMP 25-Dec-14	KWD 0.740
Target Price	KWD 0.755
Upside/Downside	+2.1%

Investment Thesis

We are initiating coverage on KFH with a Neutral rating and a price target of KWD 0.755 per share representing an upside potential of 2.1% on the stock. *The Bank's Net Interest Income (NII) grew at a compounded rate of 5% over the last five years, slightly above the Sector's growth of 4.1%, amid the low interest rates and strict lending guidelines. As well, Net Interest Margin has been on the decline since 2008, as it was the case for all other banks, dropping from a high of 3.83% in 2008, to currently stand at around 3.11%.*

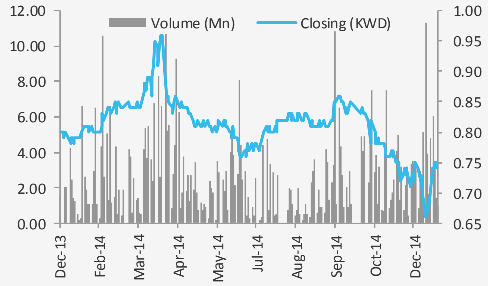
Looking ahead, we estimate the growth in NII to pick-up *over the next 5 years to reach KWD 511 Mn by the end of 2018, which is a CAGR of 8.7%. The growth in NII will be driven by higher lending volume as well as enhanced NIM which we estimate to show gradual yet slight improvements to reach 3.38% by 2018.*

Loan loss reserve was and remains the key concern for KFH *after the hike seen in NPLs since the financial crisis in 2008. However, in spite of the high amount of provisions taken by the Bank, the coverage ratio remains relatively at its lowest level. Over the forecast horizon, we believe that KFH will keep on taking additional provisions yet cut down the amount gradually with the improvement in the Bank's asset quality and coverage and as default risk normalizes.*

KFH's Net Profit dropped by an annual rate of around 5.9% over the period 2008-2013*, on the back of the challenging operating environment and the high amount of provisions and impairments. Going forward, we estimate Net Profit to reach KWD 192 Mn in 2018, that is a CAGR of 10.6%; while, we forecast both ROAA and ROAE to gradually improve to reach 0.9% and 10.5% in 2018.*

We expect that the quality of loans to keep on improving gradually *in line with our expectation of a recovery in the market conditions and a normalization of default risk, along with the Bank's efforts to strengthen its balance sheet by undertaking more rigorous approach towards risk management and allocation of funds in specific sectors.*

Key Indicators	2013	2014e	2015e	2016e	2017e	2018e
Net Interest Income (KWD Mn)	336.4	411.7	445.4	472.8	492.2	510.9
Net Profit (KWD Mn)	115.9	125.2	145.4	163.6	179.9	191.8
NPL to Gross Loans	9.5%	8.2%	7.7%	7.2%	6.7%	6.2%
NPL Coverage Ratio (X)	0.59	0.70	0.83	0.95	1.07	1.20
NIM (%)	3.11%	3.25%	3.18%	3.29%	3.33%	3.38%
Spread (%)	3.34%	3.39%	3.34%	3.49%	3.60%	3.71%
ROAA (%)	0.8%	0.7%	0.8%	0.8%	0.9%	0.9%
ROAE (%)	7.8%	7.4%	8.5%	9.4%	10.1%	10.5%
EPS (KWD)	0.033	0.031	0.034	0.038	0.042	0.044
BVP (KWD)	0.459	0.416	0.426	0.437	0.449	0.461
PE (X)	24.47	24.14	22.05	19.60	17.82	16.71
PB (X)	1.74	1.78	1.74	1.69	1.65	1.61
Yield (%)	1.63%	2.28%	2.54%	3.01%	3.48%	3.89%



Price Perf.	1M	3M	12M
Absolute	1.4%	-12.9%	5.8%
Relative	6.1%	-1.8%	8.4%

Stock Data	
Bloomberg Ticker	KFIN KK
Reuters Ticker	KFIN.KW
Last Price (KWD)	0.740
M.Cap (KWD Mn)	3,206
M.Cap (USD Mn)	10,963
52-Week Range (KWD)	0.960/0.650
52-Week ADVT (KWD Mn)	2.067

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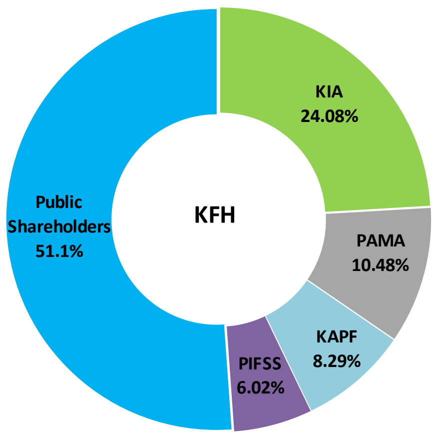
Company Overview

Kuwait Finance House (KFH) was established in 1977 as the first Islamic financial institution in Kuwait providing a wide range of banking Shari'a compliant products and services, covering real estate, trade finance, investment portfolios, commercial, retail and corporate banking and is available in Kuwait, Kingdom of Bahrain, Kingdom of Saudi Arabia, United Arab Emirates, Turkey, Malaysia, and Australia. KFH's Group banking network spans across seven regions worldwide, with 355 branches, over 475 ATMs and approximately 8,000 employees.

The Bank was listed on the Kuwait Stock Exchange in 1984 and currently it is the 2nd largest listed company on KSE with a market capitalization of KWD 3.21 billion (USD 10.98 billion) at the end of 25 December 2014. In addition to offering all traditional banking and financing services, KFH is heavily involved in the real estate sector. Its involvement in the real estate sector includes the direct construction and marketing of properties and offering the necessary financing for the buyers, in addition to real estate development and management.

KFH's Shareholding Structure



Source: Kuwait Stock Exchange

KFH's largest shareholders include: Kuwait Investment Authority (KIA), Kuwait Awqaf Public Foundation (KAPF), Public Authority for Minors' Affairs (PAMA), The Public Institution for Social Security (PIFSS).

Key Developments & Credit Rating Update

Major international rating agencies, namely Moody's, Fitch Ratings and Standard & Poor's continue to rate KFH's L-T and S-T ratings. Standard and Poor's, the international rating agency, has recently upgraded KFH's future outlook to stable from negative, and it affirmed its long-term and short-term credit ratings at A-, and A-2 respectively.

Rating Agency	Long Term	Short Term	Oultlook
Fitch	A+	F-1	Stable
Standard & Poor's	A-	A-2	stable
Moody's	A1	P-1	Negative

Source: Rating Agencies

KFH Subsidiaries

Company Name	Country	Ownership	Principal Activity
Kuwait Finance House (Malaysia) Berhard	Malaysia	100.00%	Islamic finance products, investment in real estate
KFH Private Equity Ltd	Cayman Islands	100.00%	Global private equity investments
KFH Financial Services Ltd	Cayman Islands	100.00%	Real estate sector outside Kuwait
Al-Muthanna Investment Company K.S.C. (Closed)	Kuwait	100.00%	Islamic financing services, real estate investments
Kuwait Finance House Real Estate Company K.S.C (Closed)	Kuwait	100.00%	Owning, sale and purchase of real estate
Development Enterprises Holding Company K.S.C	Kuwait	100.00%	Owning long-term strategic assets through investment or financing
Baitak Real Estate Investment Company S.S.C. (Closed)	Saudi Arabia	100.00%	Investments and real estate development
Kuwait Finance House Investment Company K.S.C. (Closed)	Kuwait	100.00%	Financing activities, and high quality/low risk investment
Saudi Kuwaiti Finance House S.S.C. (Closed)	Saudi Arabia	100.00%	Advisory services and custody
International Turnkey Systems Company K.S.C. (Closed)	Kuwait	97.00%	Marketing, developing of hardware and software
Kuwait Finance House (Bahrain) B.S.C.	Bahrain	100.00%	Products and banking services
Kuwait Turkish Participation Bank	Turkey	62.00%	Islamic banking and finance services
ALAFCO – Aviation Lease & Finance Co. K.S.C. (Closed)	Kuwait	53.00%	Purchase and leasing of aircraft
Aref Investment Group K.S.C. (Closed)	Kuwait	52.00%	Real estate investments & financing activities
Al Enma'a Real Estate Company K.S.C. (Closed)	Kuwait	50.00%	Real estate activities including operating leases
Public Service Company K.S.C. (Closed)	Kuwait	80.00%	Management consultancy and services

Source: KFH Annual Report 2013

KFH Associates

Company Name	Country	Ownership	Principal Activity
Specialties Group Holding Company K.S.C. (Closed)	Kuwait	40.00%	Holding Investments
First Takaful Insurance Company K.S.C. (Closed)	Kuwait	28.00%	Islamic Takaful Insurance
Gulf Investment House K.S.C. (Closed)	Kuwait	20.00%	Islamic Investments
Sharjah Islamic Bank P.J.S.C.	UAE	20.00%	Islamic Banking Services
Elaf Bank (Indirect)	Bahrain	29.00%	Islamic Banking Services

Source: KFH Annual Report 2013

KFH Joint Ventures

Company Name	Country	Ownership	Principal Activity
Durrat Khaleej Al-Bahrain Company B.S.C.	Bahrain	50.00%	Real estate development
Diyar Homes Company W.L.L (Shoug Al-Muharraq)	Bahrain	50.00%	Real estate development
Al Durrat Al-Tijaria Company W.L.L	Bahrain	50.00%	Real estate development
Diyar Al-Muharraq Company W.L.L.	Bahrain	52.00%	Real estate development
PK Development Properties Company W.L.L.	Bahrain	50.00%	Real estate development
Metragold Assets SDN BHD	Malaysia	80.00%	Real estate development
Al Asad PTE LTD	Singapore	50.00%	Real estate development
Intrared Holding Co. Limited	Malaysia	60.00%	Real estate development
Queristics Investment Sarl, Europe	Europe	95.00%	Real estate development
US Healthcare Venture LLC	US	95.00%	Real estate development
K/UDR Venture LLC	UK	70.00%	Real estate development
Killam KFH – Sigma Properties LP	Canada	72.50%	Real estate development
DIC Frankfurt Objekt Zeil GmbH	Germany	70.00%	Real estate development
Orange Pearl Properties SCI - Sas Multibureaux, Paris	France	70.00%	Real estate development

Source: KFH Annual Report 2013

Historical Price Performance

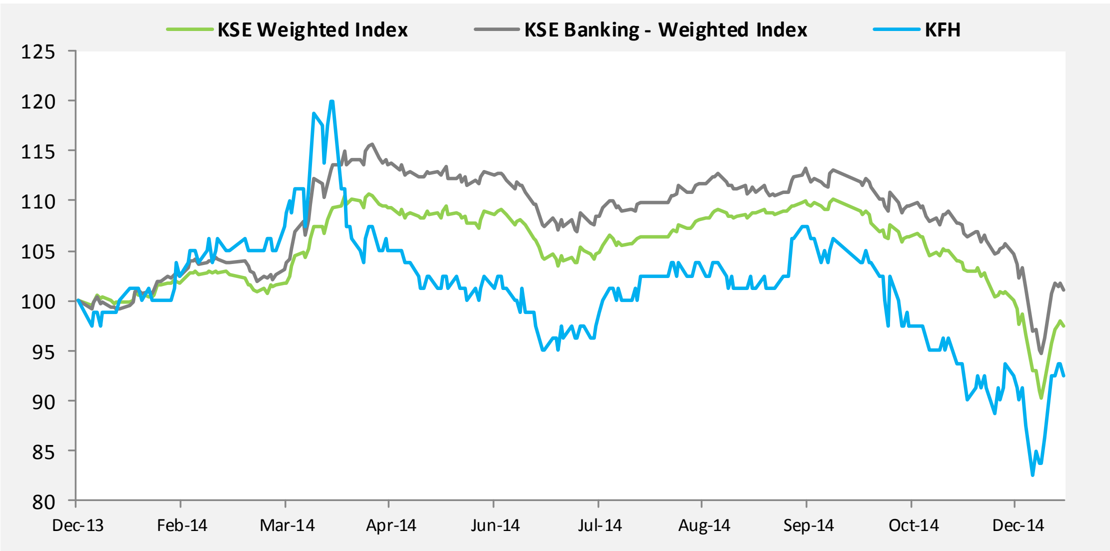
KFH's current share price as on 25 Dec-14 was KWD 0.740, recording a year to date increase of 6.4% (adjusted for dividends) resulting in total market capitalization of KWD 3.21 billion.

During the last 52 weeks KFH's closing price reached the highest price of KWD 0.960 while the lowest during the same period was KWD 0.650. Since the listing date in 1984 KFH's price reached the highest price ever of KWD 3.960 on 09 March 2008 before the financial crisis starts.

Based on the 9M-2014 financial results, trailing twelve month PE multiple works out to be 27.43x as compared to Kuwaiti Banking Sector PE of 21.52x, while KFH's PB stood at 1.81x compared to 1.75x for the Kuwaiti Banking Sector.

On the other hand, dividend yield stood at 1.53% below the sector dividend yield of 2.23%. The bank's beta stood at 1.51 based on the historical price for more than 5 years. The YTD-2014 capital turnover ratio recorded 14.2%.

KFH Stock Price Performance Vs. KSE Wtd index and Banking Wtd index



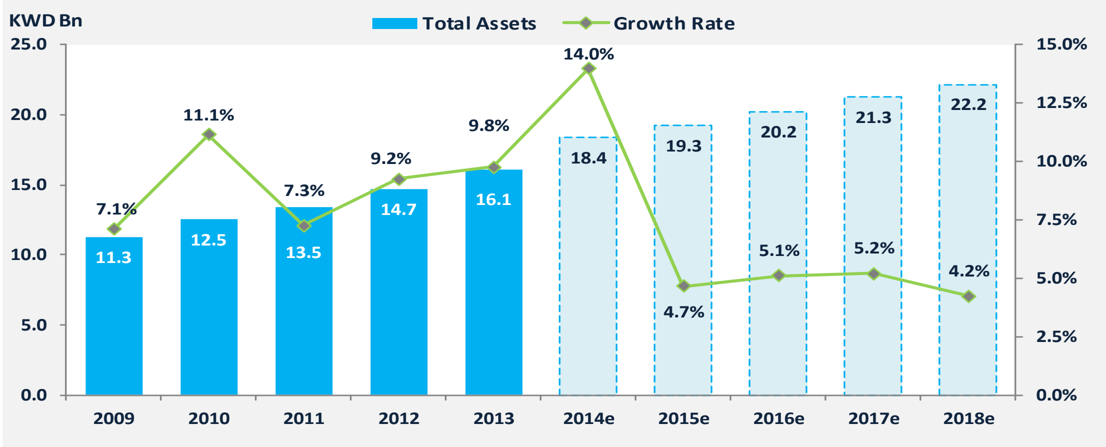
Source: KSE & KAMCO Research (Rebased Index 100)

Asset Structure & Funding Base

Balance Sheet Size

KFH's total assets grew by a compounded annual growth of 8.9% over the historical 5-year period, surpassing the Sector's growth rate of 6.3% over the same period, to stand at KWD 16.1 Bn as of Dec-2013 and further increased by 5.9% to reach KWD 17.1 Bn in Sep-2014. The growth in the Bank size is mainly supported by its pioneer position in Islamic Banking as well as the Bank's expansionary strategy and current presence in International markets i.e. Turkey and Malaysia. We forecast the Bank's assets to grow at a compounded annual rate of 6.6% over the project 5-year horizon and reach KWD 22.2 Bn as of Dec-2018.

Total Assets - Historical and Expected Growth Tends

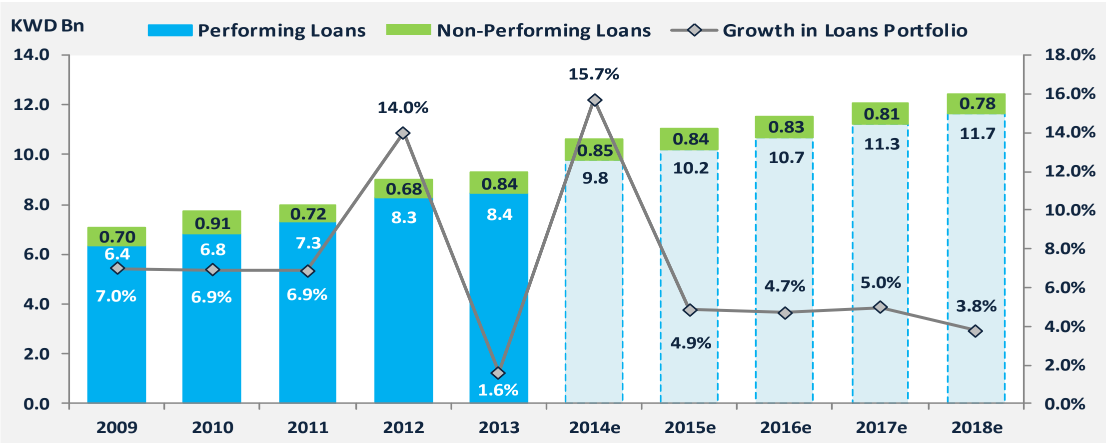


Source: KFH Financials and KAMCO Research

Size and Quality of Loans Portfolio

For the last 5-year period, and despite the slowdown in the lending activities by most banks, KFH loans portfolio grew by a CAGR of 7.3%, as compared to a growth of 4.8% for the sector, to stand at KWD 8.9 Bn as of Dec-2013. Looking ahead, and as we expect an elevated competition by other local Islamic banks, we forecast KHF's loans portfolio to grow at a CAGR of 7.2% over the next 5 years and to reach KWD 12.7 Bn. On the other hand, we expect that the quality of loans to keep on improving gradually in line with our expectation of a recovery in the market conditions and a normalization of default risk, along with the Bank's efforts to strengthen its balance sheet by undertaking more rigorous approach towards risk management and allocation of funds in specific sectors.

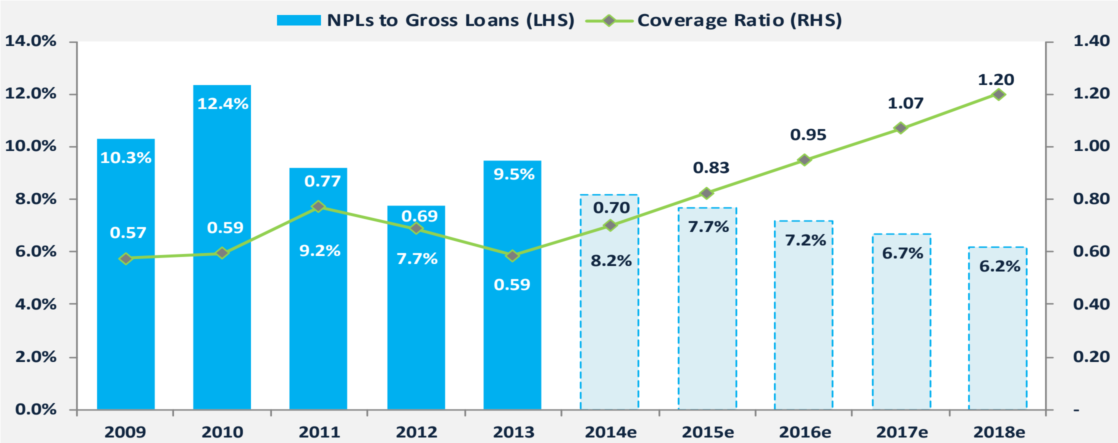
Loans Portfolio - Growth & Quality



Source: KFH Financials and KAMCO Research

NPLs to gross loans ratio stood at a high of 10.3% by the end of 2009, when the high level of credit default during the financial crisis resulted in a bounce in the amount of NPLs which recorded KWD 705 Mn and KWD 699 Mn in 2008-2009, respectively; however the NPLs ratio showed gradual improvements to reach 9.5% as of Dec-2013. On the other hand, the Bank suffered from a deterioration in its NPLs coverage ratio which stood at 0.59x in 2013, way below the sector average ratio of 1.1x and among the lowest as compared to its peers. Over the projected horizon, we expect the NPL ratio to drop gradually from its current level of 9.5% to reach 6.2% by the end of 2018 as the Bank takes additional measures to improve the quality of its loans portfolio. As well, given the high requirements set by the CBK, we believe that the Bank will keep on taking additional provisions in order to improve the coverage ratio which we estimate to gradual rise to reach 1.2x by 2018.

NPLs and Coverage Ratios

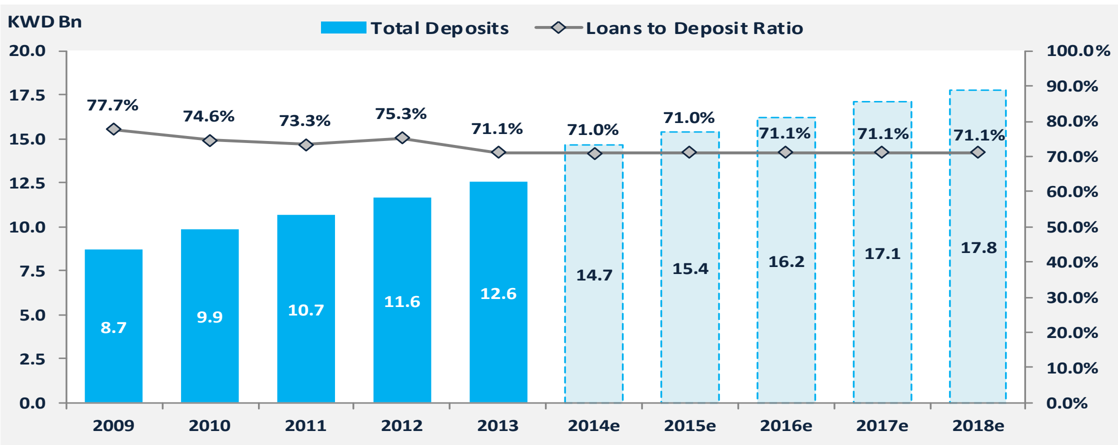


Source: KFH Financials and KAMCO Research

Funding Base and Loans to Deposit Ratio

KFH deposit base grew at a compounded annual rate of 8.9% over the last five years, above sector average growth of 6.3%, to currently stand at KWD 14.3 Bn as of Sep-2014, that is an additional growth of around 13.8% compared to Dec-2013. Going forward, we expected the growth in total deposits to record a CAGR of 7.2% over the next 5-years and to reach KWD 17.8 Bn by the end of 2018. On the other hand, loan-to-deposit ratio dropped from 77.7% in 2009 to reach 71.1% in 2013, as the Bank applied more strict lending policies in order to put a limit NPL formation. Over the next five years, we estimate the ratio of loans-to-deposits to remain at the current level. The forecasted ratio of loan-to-deposit is mainly based on the maturity profile of the Bank's funding base and the lending ratio set by the Central Bank of Kuwait for each bracket according to maturity.

Total Deposit Base & Loans-to-Deposits Ratio

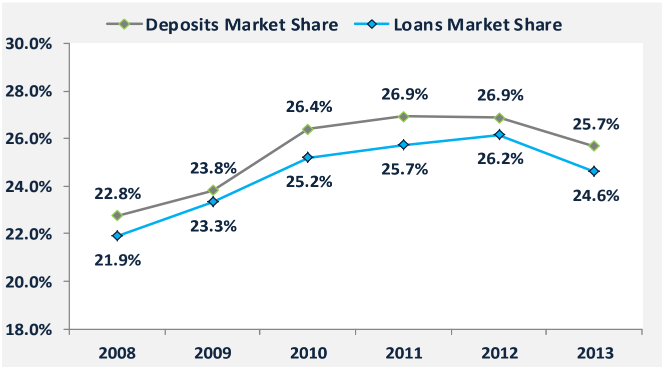


Source: KFH Financials and KAMCO Research

Market Share of Loans & Deposits

The market share of KFH's loans portfolio has trended upward to represent around 26.2% in 2012 up from 21.9% in 2008, yet then dropped to 24.6% in 2013 with the increased competition among Islamic Banking Institutions and the establishment of Warba Bank. Similarly, market share of deposit have followed the same trend to reach 25.7% in 2013, up from 22.85% in 2008. Over the projected 5-year horizon, we envisage KFH market share to marginally decline, however, we believe that the leading market position of KHF is not at risk given that some of the other competitors are at their early development stages.

Market Share of Loans & Deposits

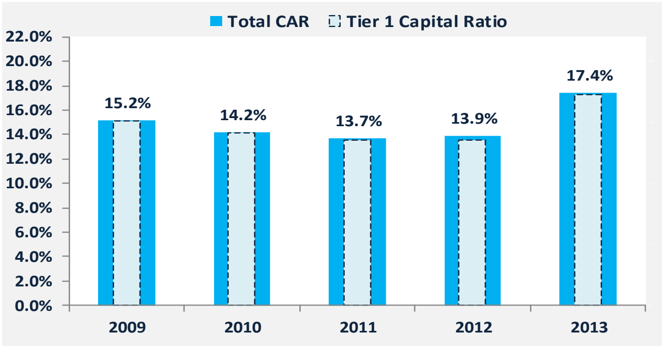


Source: KFH Financials and KAMCO Research

Equity and Capital Adequacy

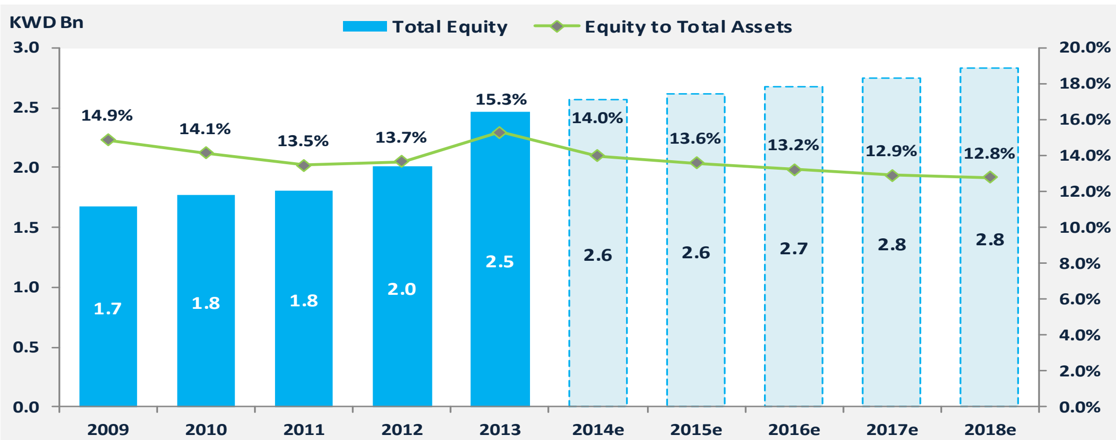
Similar to all other Kuwaiti Banks, KFH is highly capitalized with the total CAR standing at 17.4% as of Dec-2013. KFH has increased its capitalization via a 20% rights issue during 2013, therefore boosting the Bank's capital adequacy ratio as compared to 2012. As well, the Bank has maintained a high level of equity base with the equity-to-asset ratio at around 15.3%, quiet above the sector average of 12.3% as of Dec-2013. We forecast the Bank to maintain a high level of equity capital over the forecasted period, fairly above the minimum requirements set by the CBK.

Capital Adequacy Ratios



Source: KFH Financials and KAMCO Research

Shareholders' Equity



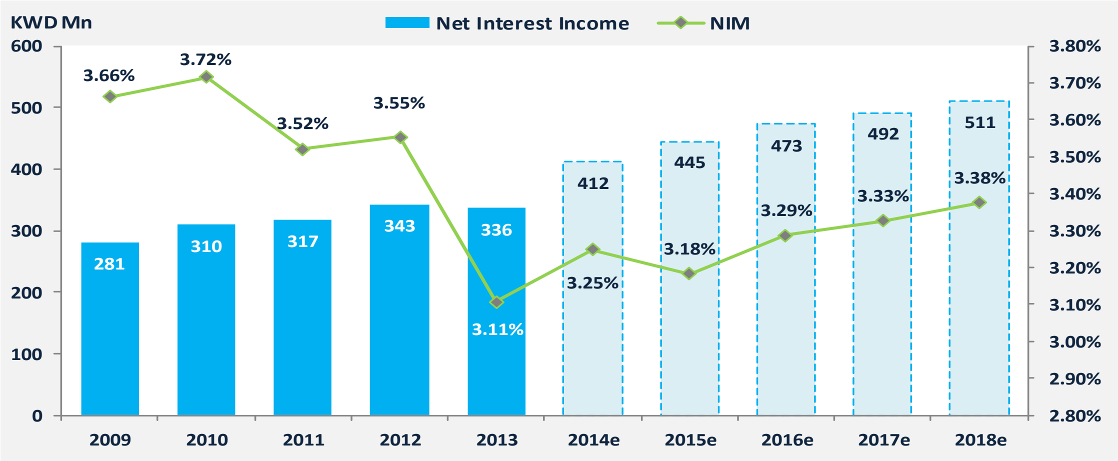
Source: KFH Financials and KAMCO Research

Profitability

Net Interest Income & Margins

In the framework of interest rates hovering at their lowest levels along with pressurized margins and strict lending guidelines, KFH's Net Interest Income (NII) grew at a compounded rate of 5% over the last five years, slightly above the Sector's growth of 4.1%. As well, Net Interest Margin (NIM) has been on the decline since the onset of the financial crisis, as it was the case for all other banks, dropping from a high of 3.83% in 2008, to currently stand at around 3.11%. Looking ahead, we estimate the growth in NII to pick-up over the next 5 years to reach KWD 511 Mn by the end of 2018, which is a CAGR of 8.7%. The growth in NII will be driven by higher lending volume as well as enhanced NIM which we estimate to show gradual yet slight improvements to reach 3.38% by 2018.

Net Interest Income & Margins

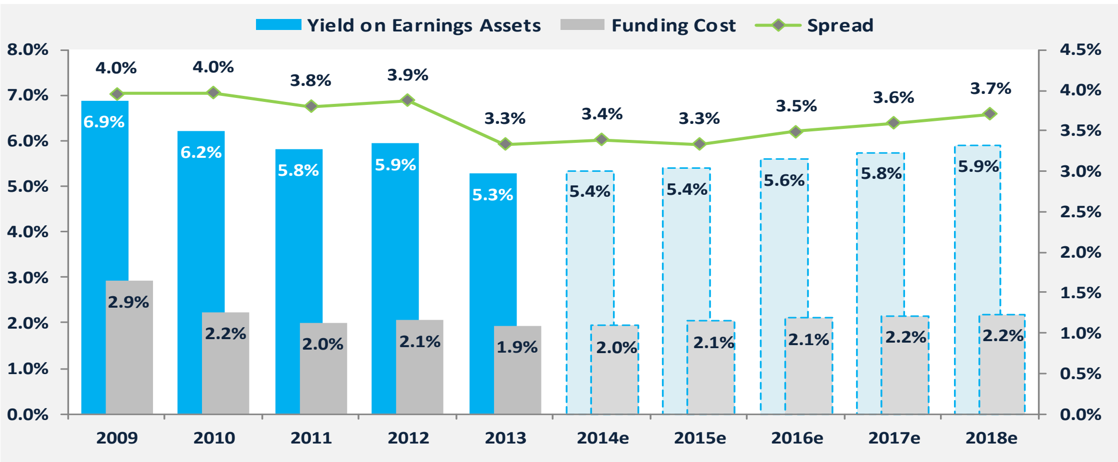


Source: KFH Financials and KAMCO Research

Moreover, interest spread went through the same downward trend from a high of around 4% during 2008-2009, to reach 3.3% in 2013. The declining interest rates had a greater impact on the yield relative to funding cost which dropped by around 210 bps to reach 1.9% in 2013, whereas yield on earnings assets dropped by a significant 290 bps over the same period.

Over the forecast horizon, we anticipate a slight to moderate improvement in interest rates and thus leading to higher margins and spreads. We expect the yield on earnings assets and funding cost to reach 3.7% and 2.2%, respectively, in 2018 and therefore resulting in a wider spread of 3.7%.

Major Profitability Margins

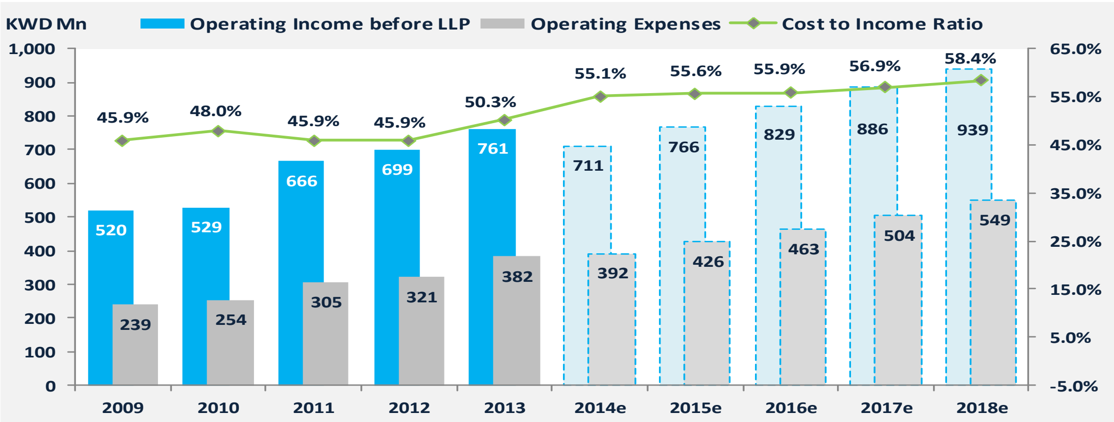


Source: KFH Financials and KAMCO Research

Operating Income and Provisions for Loan Losses

Amid the ongoing subdued economic conditions across regional and global economies, KFH total operating income grew marginally at a compounded annual rate of 5.3% over the period 2008-2013, yet higher that the sector growth of 3.9% over the same period, to record KWD 761 Mn during FY 2013. Such a marginal growth in operating income relative to the pre-crisis outstanding growth levels owes mainly to lower interest margins, lower brokerage and investment income as well as lower growth in core business activities. Moreover, over the 9M-2014 period, KFH operating income dropped by around 10.1% to record KWD 475 Mn, compared to KWD 529 Mn recorded during 9M-2013, mainly due to the lower non-interest income particularly investments income and net fees and commissions income. On the other hand, KFH's operating expenses increased at a CAGR of 14.3% in the middle of an increasingly inflationary cost environment and in line with banks' expansionary strategies. Accordingly, cost to income ratio has increased from 33.3% in 2008 to reach a high of 50.3% in 2013, way above the sector average ratio of 43.1% in 2013.

Operating Efficiency



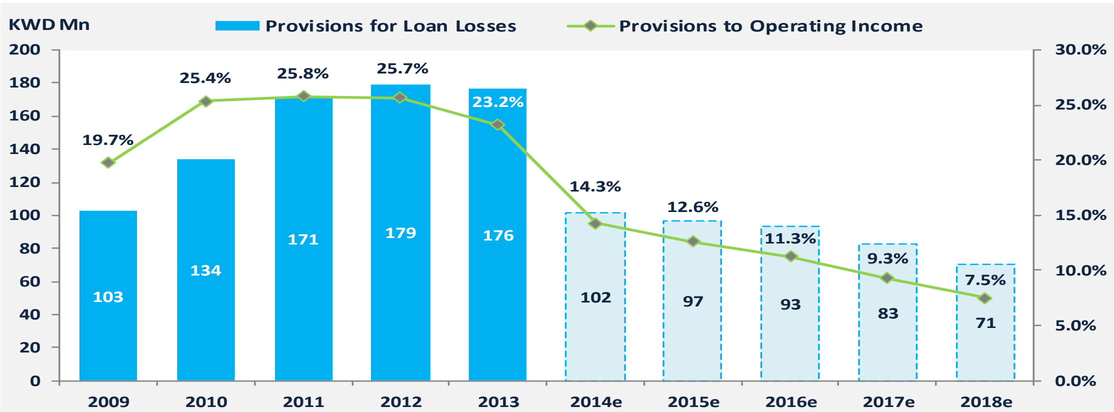
Source: KFH Financials and KAMCO Research

Looking ahead, we forecast operating income to grow at a compounded annual rate of 4.3% as margins and spreads increase and as equity markets recovers gradually; while on the other hand we assume a CAGR of 7.5% in operating expenses taking into consideration the Bank's expansionary strategy and the expected inflation level over the next 5 years.

Provisions for Loan Losses

As it is the case for most of the local and regional Banks, loan loss reserve was and remains the key concern for KFH after the hike seen in NPLs since the financial crisis in 2008. However, in spite of the high amount of provisions taken by the Bank, the coverage ratio remains relatively at its lowest level.

Operating Income & Provisions for Loan Losses



Source: KFH Financials and KAMCO Research

In relative terms, the amount of provisions taken by KFH since 2008 consumed on average around 25% of the Banks' Operating Income. Looking ahead, given the Bank's low coverage ratio and the significant amount of NPLs relative to loans portfolio, we believe that KFH will keep on taking additional provisions yet cut down the amount gradually with the improvement in the Bank's asset quality and coverage and as default risk normalizes.

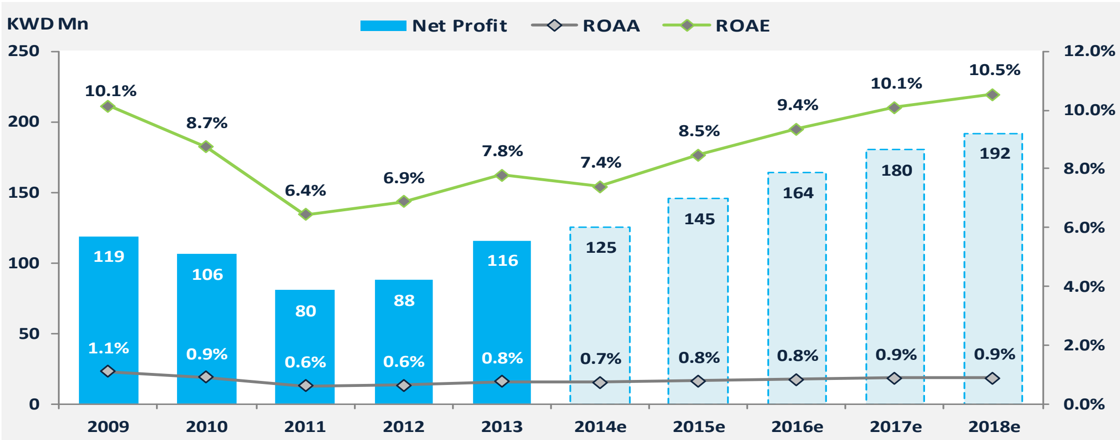
Bottom Line Results & Key Profitability Ratios

KFH's Net Profit dropped by an annual rate of around 5.9% over the period 2008-2013, on the back of the high amount of provisions and impairments that the bank took over the period, along with a challenging operating environment affecting the core revenues of the bank. As well, the 9M-2014 results showed a minor increase in Net Profit of 1.1% as compared to last comparable period, to record KWD 90.1 Mn, owing to the huge drop in investment income in addition to lower fees and commissions income.

Moreover, the banks' core profitability ratios, ROAA and ROAE are at their low levels standing at 0.8% and 7.8%, respectively, in 2013 and average around 0.8% and 8% over the last 5-year period, marginally below the sector average ratios of 1.1% and 8.7% over the same period, respectively.

Going forward, we estimate Net Profit to reach KWD 192 Mn in 2018, that is a CAGR of 10.6%. Therefore, we forecast both ROAA and ROAE to gradually improve to reach 0.9% and 10.5% in 2018.

Net Income & Key Profitability Measures



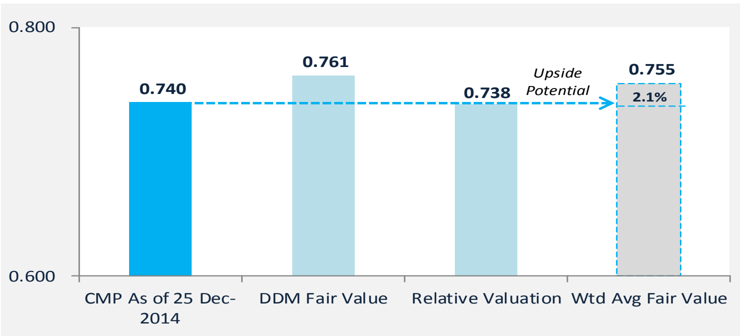
Source: KFH Financials and KAMCO Research

Valuation & Recommendation

"Neutral" rating with a Price Target of KWD 0.755 representing an upside potential of 2.1%

We have valued the Bank using Dividend Discount Model (DDM) and relative valuation based on Price to Book Value Multiple. We have assigned 75% weight to the DDM-based valuation and 25% weight to the relative valuation in order to arrive at an estimated fair value of KWD 0.755 per share.

KFH Fair Value Per Share Vs. Market Price



Valuation Method			
	Value KWD	Weight (%)	Weighted Value KWD
DDM Fair Value Per Share	0.761	75%	0.571
Relative Valuation Per Share	0.738	25%	0.185
Weighted Average Fair Value per Share			**0.755**
Current Market Price			0.740
Upside/Downside			***2.1%***

Discounted Cash Flow Model

Our DDM valuation method is based on explicit forecast of dividend payments for the next five fiscal years (2014e-2018e) and a terminal value afterward based on a target price to book value multiple. Our discount factor is based on a modified Capital Asset Pricing Model which takes into account various risk premiums pertaining to equity market risk, company specific risk, as well as industry related risk factors on top of the risk free rate. The forecasted dividends over the projected horizon are discounted back using a cost of equity of 11.2%. We assumed a terminal growth rate of 3.0% in computing the terminal value considering the long-term growth in the economy and its impact on the sector and the Bank.

DDM Valuation	**Fair Value of Equity (KWD Mn)**	**Fair Value Per Share (KWD)**
Present Value of Dividends	373	0.088
Present Value of Terminal Value	2,871	0.674
Equity Fair Value	**3,244**	**0.761**

Based on the aforementioned methodology and assumptions, we arrived at an estimated fair value for KFH's equity at KWD 3.24 Bn, which, considering 4.26 Bn outstanding shares, translates to per share fair value price of KWD 0.761.

Sensitivity Analysis

The sensitivity analysis for the change in fair value share price to the changes in cost of equity and the terminal growth rate is mentioned in the below table.

Price Sensitivity based on DDM Model								
		Cost of Equity						
		10.5%	11.0%	11.5%	11.2%	12.0%	12.5%	13.0%
Terminal Growth Rate	2.00%	0.806	0.752	0.704	0.734	0.662	0.623	0.588
	2.25%	0.814	0.759	0.710	0.740	0.666	0.626	0.591
	2.50%	0.823	0.766	0.715	0.747	0.670	0.630	0.593
	2.75%	0.833	0.774	0.721	0.754	0.675	0.633	0.596
	3.00%	0.843	0.782	0.728	0.761	0.680	0.637	0.599
	3.25%	0.854	0.790	0.734	0.769	0.685	0.641	0.602
	3.50%	0.866	0.800	0.742	0.778	0.691	0.645	0.605
	3.75%	0.879	0.809	0.749	0.786	0.696	0.650	0.609
	4.00%	0.892	0.820	0.757	0.796	0.703	0.655	0.612

Relative Valuation

For peer-based valuation, we have used the forward price to book value based on the 2015 expected Net Profit and the current market capitalization, which resulted in relative share price of KWD 0.738, based solely on the relative valuation.

Company	Country	M.Cap USD Mn	PE (x) 2015e	PB (x) 2015e
Qatar National Bank	Qatar	40,734	12.64	2.26
National Commercial Bank	Saudi	31,739	15.03	2.41
Al Rajhi Bank	Saudi	23,659	11.00	1.98
First Gulf Bank	UAE	17,944	10.91	2.01
National Bank of Kuwait	Kuwait	14,923	10.83	1.62
National Bank of Abu Dhabi	UAE	17,343	11.04	1.64
Saudi British Bank	Saudi	14,951	12.25	1.93
Riyad Bank	Saudi	14,253	11.38	1.42
SAMBA	Saudi	13,112	9.63	1.21
Kuwait Finance House	Kuwait	11,100	14.62	1.62
Emirates NBD	UAE	13,013	8.14	1.16
Abu Dhabi Commercial Bank	UAE	11,136	9.35	1.64
Arab National Bank	Saudi	8,293	10.38	1.34
Burgan Bank	Kuwait	3,234	9.77	1.60
Commercial Bank of Kuwait	Kuwait	2,943	11.50	1.35
Bank Muscat	Oman	3,492	7.38	0.91
		241,870	**11.34**	**1.73**

Source: KAMCO Research & Bloomberg

Recommendation

Based on our valuation, the Bank is currently trading at a 2.0% discount to our weighted average fair value estimate indicating a "**Neutral**" rating following KAMCO's recommendation scale and a price target of KWD 0.755 per share representing an upside potential of 2.1% on the stock.

Financial Indicators

Balance Sheet (KWD Mn)	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Assets								
Cash and Cash Equivalents	620	814	1,070	1,161	1,417	1,703	2,000	2,297
Short-term Murabaha	1,478	1,186	2,432	3,344	3,226	3,100	2,952	2,747
Net Loans & Advances	7,287	8,306	8,439	9,763	10,239	10,721	11,252	11,676
Investment Securities	1,302	1,249	1,216	998	1,088	1,189	1,298	1,399
Investment in Associates & Joint Ventures	490	580	618	621	624	627	630	634
Other Assets	2,283	2,568	2,365	2,509	2,660	2,897	3,158	3,437
Total assets	**13,460**	**14,703**	**16,140**	**18,396**	**19,253**	**20,236**	**21,290**	**22,189**
Liabilities								
Customer Deposits	8,882	9,393	10,104	11,216	12,110	13,015	13,856	14,394
Due to Banks and FIs	1,819	2,255	2,469	3,456	3,283	3,201	3,233	3,395
Other Liabilities	682	735	762	771	814	860	909	960
Total liabilities	**11,382**	**12,383**	**13,335**	**15,443**	**16,208**	**17,076**	**17,998**	**18,749**
Shareholders' Equity								
Share capital	269	290	383	433	433	433	433	433
Share premium	465	465	720	720	720	720	720	720
Other Reserves	1,079	1,254	1,365	1,421	1,465	1,525	1,597	1,682
Total Shareholders Equity	**1,813**	**2,009**	**2,469**	**2,574**	**2,618**	**2,679**	**2,751**	**2,835**
Minority Interest	265	311	336	378	427	481	541	605
Total liabilities and equity	**13,460**	**14,703**	**16,140**	**18,396**	**19,253**	**20,236**	**21,290**	**22,189**

Income Statement (KWD Mn)	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Financing Income	524	574	571	678	756	806	851	893
Distribution to Depositors	(207)	(230)	(235)	(267)	(310)	(333)	(359)	(382)
Net Interest & Islamic Financing Income	**317**	**343**	**336**	**412**	**445**	**473**	**492**	**511**
Net Commission Income	56	73	80	91	100	105	110	114
Investment & Dividend Income	190	229	246	121	125	151	178	203
Other Income	102	53	99	88	95	101	106	111
Total Non-Interest Income	**348**	**355**	**425**	**300**	**321**	**356**	**394**	**428**
Total Operating Income	**666**	**699**	**761**	**711**	**766**	**829**	**886**	**939**
Provisions Expenses & Impairments	(321)	(251)	(224)	(146)	(138)	(139)	(132)	(125)
Operating Expenses	(305)	(321)	(384)	(392)	(426)	(463)	(504)	(549)
Profit before Taxation & Minority Interest	**39**	**127**	**153**	**173**	**201**	**227**	**249**	**266**
Taxation	(2)	(3)	(4)	(7)	(8)	(9)	(9)	(10)
Minority Interest	43	(36)	(33)	(42)	(48)	(55)	(60)	(64)
Net Profit Attributable to Shareholders	**80**	**88**	**116**	**125**	**145**	**164**	**180**	**192**
EPS (KWD)	**0.028**	**0.026**	**0.033**	**0.031**	**0.034**	**0.038**	**0.042**	**0.044**

Source: KAMCO Research and Kuwait Finance House

Key Financial Ratios

Key Ratios	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Profitability Ratios								
Return on Average Assets	0.6%	0.6%	0.8%	0.7%	0.8%	0.8%	0.9%	0.9%
Return on Average Equity	6.4%	6.9%	7.8%	7.4%	8.5%	9.4%	10.1%	10.5%
Net Interest Income/ Total Income (pre-provisions)	47.7%	49.1%	44.2%	57.9%	58.2%	57.0%	55.6%	54.4%
Fees and Commissions/ Total Op. Income	16.3%	16.3%	14.8%	16.0%	15.9%	15.1%	14.5%	14.0%
Non-Interest Income/ Total Income (pre-provisions)	52.3%	50.9%	55.8%	42.1%	41.8%	43.0%	44.4%	45.6%
Dividend Payout Ratio	49.3%	32.4%	42.3%	55.0%	56.0%	59.0%	62.0%	65.0%
Operating Profit Growth Rate (y-o-y)	-49.2%	226.1%	21.1%	13.2%	16.2%	12.5%	9.9%	6.6%
Total Provisions to Operating Profits	25.8%	25.7%	23.2%	14.3%	12.6%	11.3%	9.3%	7.5%
Margins & Spreads								
Net income/ Revenues	15.3%	15.3%	20.3%	18.5%	19.2%	20.3%	21.1%	21.5%
Operating Profit / Revenues	7.4%	22.1%	26.8%	25.6%	26.7%	28.1%	29.3%	29.8%
Interest Expense to Interest Income	39.4%	40.1%	41.1%	39.3%	41.0%	41.3%	42.1%	42.8%
Yield on Average Earnings Assets	5.81%	5.94%	5.28%	5.35%	5.40%	5.60%	5.75%	5.90%
Funding Cost	2.01%	2.06%	1.94%	1.96%	2.06%	2.11%	2.15%	2.19%
Net Spread	3.80%	3.88%	3.34%	3.39%	3.34%	3.49%	3.60%	3.71%
Net Interest Margin	3.52%	3.55%	3.11%	3.25%	3.18%	3.29%	3.33%	3.38%
Operating Efficiency Ratios								
Cost to Total Op Income	45.9%	45.9%	50.3%	55.1%	55.6%	55.9%	56.9%	58.4%
Staff Expense to Total Op. Income	18.7%	19.3%	22.2%	25.5%	25.5%	25.5%	25.8%	26.2%
Cost to Average Total Assets	2.3%	2.3%	2.5%	2.3%	2.3%	2.3%	2.4%	2.5%
Liquidity Ratios								
Net Loans to Interest Earnings Assets	79%	82%	73%	71%	72%	74%	75%	77%
Gross Loans to Customer Deposits	72%	75%	69%	72%	71%	71%	70%	71%
Gross Loans to Total Deposits	60%	61%	55%	55%	56%	57%	57%	57%
Gross Loans to Total Assets	47%	48%	43%	44%	45%	45%	46%	46%
Due from Banks to Due to Banks	81%	53%	99%	97%	98%	97%	91%	81%
Credit Quality Ratios								
Non-Performing Loans / Gross Loans	9.2%	7.7%	9.5%	8.2%	7.7%	7.2%	6.7%	6.2%
Loan-Loss Reserve / Gross Loans	8.8%	6.6%	7.2%	7.4%	8.0%	8.6%	8.9%	9.3%
Loan-Loss Reserve / Non-perofrming Loans (Coverage)	0.77	0.69	0.59	0.70	0.83	0.95	1.07	1.20
Loan-Loss Provision / Total Op. Income	49.8%	40.1%	32.8%	18.0%	15.4%	13.5%	11.0%	8.7%
Capital Adequacy Ratios								
Equity to Total Assets	9.3%	8.8%	10.4%	9.3%	9.0%	8.7%	8.5%	8.3%
Equity to Gross Loans	19.7%	18.4%	24.2%	21.1%	20.0%	19.2%	18.5%	18.1%
Market Data and Valuation Ratios								
Closing Share Price (KWD)	0.900	0.810	0.800	0.740	0.740	0.740	0.740	0.740
Number of Shares (Mn)	2,689	2,904	3,834	4,332	4,332	4,332	4,332	4,332
Market Capitalization (KWD Mn)	2,420	2,352	3,067	3,206	3,206	3,206	3,206	3,206
EPS (KWD)	0.028	0.026	0.033	0.031	0.034	0.038	0.042	0.044
Book Value Per Share (KWD)	0.489	0.467	0.459	0.416	0.426	0.437	0.449	0.461
Dividend Per Share (KWD)	0.015	0.010	0.013	0.017	0.019	0.022	0.026	0.029
Price to Earnings Multiple (X)	32.12	30.60	24.47	24.14	22.05	19.60	17.82	16.71
Price to Book Value Multiple (X)	1.84	1.73	1.74	1.78	1.74	1.69	1.65	1.61
Dividend Yield (%)	1.7%	1.2%	1.6%	2.3%	2.5%	3.0%	3.5%	3.9%

Source: KAMCO Research and Kuwait Finance House

Note : Forward Valuation ratios are based on current market prices

KAMCO Research

December - 2014

Gulf Bank

Outperform

CMP 25-Dec-14	KWD 0.290
Target Price	KWD 0.351
Upside/Downside	+21.0%

Investment Thesis

We are initiating coverage on Gulf Bank with an Outperform rating and a price target of KWD 0.351 per share representing an upside of 21.0% on the stock. *The Bank's NII grew at a compounded rate of 0.5% over the last five years after the drop seen in 2009 when NPLs ratio jumped to 30%. On the other hand, NIM has been showing improvements since 2009 as the Bank not only managed to contain the formation of NPLs but also improved the quality of its portfolio, to currently stand at 2.7%, yet still below the sector average of 3.30%.*

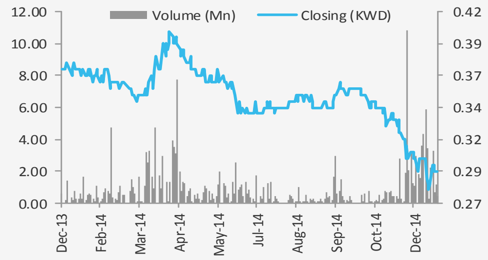
Looking ahead, we estimate the growth in NII to pick-up over the next 5 years to *reach KWD 155 Mn by the end of 2018, which is a CAGR of 5.0%. The growth in NII will be driven by higher lending volume, while we expect NIM to average around 2.6%.*

As it is the case for most of the local and regional Banks, loan loss reserve was and remains the key concern for Gulf Bank *after the hike seen in NPLs since the financial crisis in 2008. Accordingly, with the high level of provisions taken during the last 5-year period, the Bank was able to increase its coverage ratio up to 100% of NPLs as of Dec-2013. Going forward, we believe that Gulf Bank will keep on taking additional provisions in order to further increase its coverage ratio yet at a gradually lower magnitude.*

Gulf Bank's Net Profit is still low *on the back of the high amount of provisions and impairments that the bank took over the period, along with a low investment income and a challenging operating environment affecting the core revenues of the bank. We forecast, Net Profit to reach KWD 63 Mn in 2018, that is a CAGR of 10.6% and therefore both ROAA and ROAE to improve to 0.9% and 4.7% in 2018.*

We expect a gradual improvement in the quality of loans portfolio *in line with our expectation of a recovery in the market conditions and a normalization of default risk, along with the Bank's efforts to strengthen its balance sheet by applying stricter lending policies.*

Key Indicators	2013	2014e	2015e	2016e	2017e	2018e
Net Interest Income (KWD Mn)	121.4	120.3	127.4	136.5	145.8	155.2
Net Profit (KWD Mn)	32.2	37.3	47.4	52.3	59.4	62.8
NPL to Gross Loans	6.5%	6.5%	6.4%	6.2%	6.2%	6.0%
NPL Coverage Ratio (X)	0.95	1.15	1.30	1.45	1.55	1.67
NIM (%)	2.70%	2.59%	2.58%	2.60%	2.62%	2.63%
Spread (%)	2.68%	2.57%	2.56%	2.58%	2.60%	2.62%
ROAA (%)	0.6%	0.7%	0.9%	0.9%	0.9%	0.9%
ROAE (%)	3.4%	3.7%	4.4%	4.4%	4.7%	4.7%
EPS (KWD)	0.012	0.013	0.016	0.018	0.020	0.022
BVP (KWD)	0.175	0.179	0.195	0.213	0.234	0.245
PE (X)	31.25	22.03	17.74	16.10	14.16	13.40
PB (X)	2.14	1.62	1.49	1.36	1.24	1.18
Yield (%)	0.00%	0.00%	0.00%	0.00%	3.53%	3.73%



Price Perf.	1M	3M	12M
Absolute	-3.3%	-18.3%	-17.7%
Relative	1.4%	-7.1%	-15.1%

Stock Data	
Bloomberg Ticker	GBK KK
Reuters Ticker	GBKK.KW
Last Price (KWD)	0.290
M.Cap (KWD Mn)	842
M.Cap (USD Mn)	2,879
52-Week Range (KWD)	0.400/0.280
52-Week ADVT (KWD Mn)	0.309

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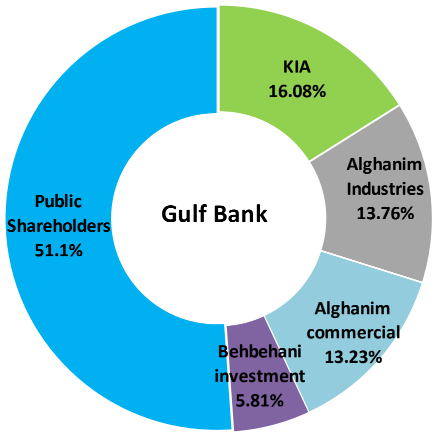
Company Overview

Gulf Bank (GBK), established in 1960, is Kuwait's third largest bank in terms of total asset size. The bank's core business is in retail banking, corporate banking, treasury and project-related international lending. The Bank was listed on the Kuwait Stock Exchange in September 1984 and the current market capitalization is KWD 842 million (USD 2.88 billion) at the end of 25 December 2014. The bank has a large network of 56 branches strategically positioned in key locations in Kuwait.

GBK's largest shareholders include: Kuwait Investment Authority (KIA), Alghanim Industries and Alghanim commercial, and Behbehani Investment.

Gulf Bank's Shareholding Structure



Source: Kuwait Stock Exchange

Key Developments & Credit Rating Update

During June 2014, Moody's Investor Services reported that Gulf Bank successful turnaround sets the stage for more balanced growth and is well positioned to take advantage of lending opportunities in Kuwait.

This came after their rating assessment in May 2014, where Moody's affirmed the Positive Outlook for Gulf Bank and upgraded overall rating to Baa1 from Baa2. Moody's also highlighted in its comments that the rating reflects the bank's "Solid revenue generating capacity, Risk Management systems and practices that are better than those of peers, and comfortable liquidity". The ratings were based on Gulf Bank's 2013 positive financial results, which were announced during the Bank's annual general meeting held in March 2014. Throughout the report, Moody's also acknowledged the heavy investment Gulf Bank has made in upgrading its risk management systems and practices, sharpening the Bank's loan selection and origination methods. In addition, S&P affirmed Gulf Bank's long-term credit rating at BBB+ with a positive outlook during 2014.

Historical Price Performance

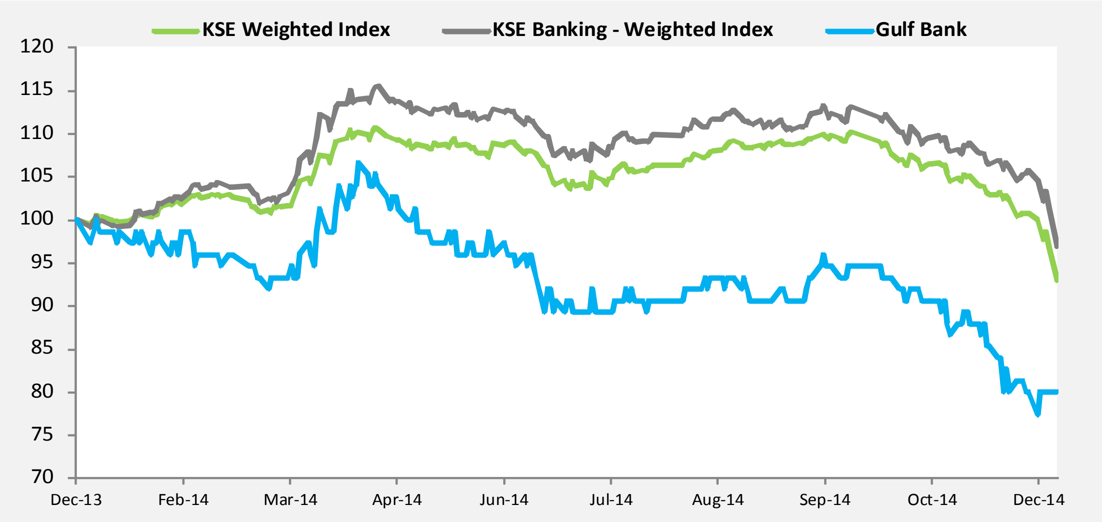
GBK's current share price as on 25 Dec-14 was KWD 0.290, recording a year to date decrease of 18.7% resulting in total market capitalization of KWD 842 million.

During the last 52 weeks GBK's closing price reached the highest price of KWD 0.400 while the lowest during the same period was KWD 0.270. Since the listing date in 1984 GBK's price reached the highest price ever of KWD 2.000 on 21 July 2007 before the financial crisis starts in 2008.

Based on the 9M-2014 financial results, trailing twelve month PE multiple works out to be 24.73x as compared to Kuwaiti Banking Sector PE of 21.52x, while GBK's PB stood at 1.68x compared to 1.75x for the Kuwaiti Banking Sector.

On the other hand, the Bank paid no dividends while the sector's dividend yield stood at of 2.23%. The bank's beta stood at 0.90 based on the historical price for more than 5 years. The YTD-2014 capital turnover ratio recorded 7.5%.

Gulf Bank Stock Price Performance Vs. KSE Wtd index and Banking Wtd index



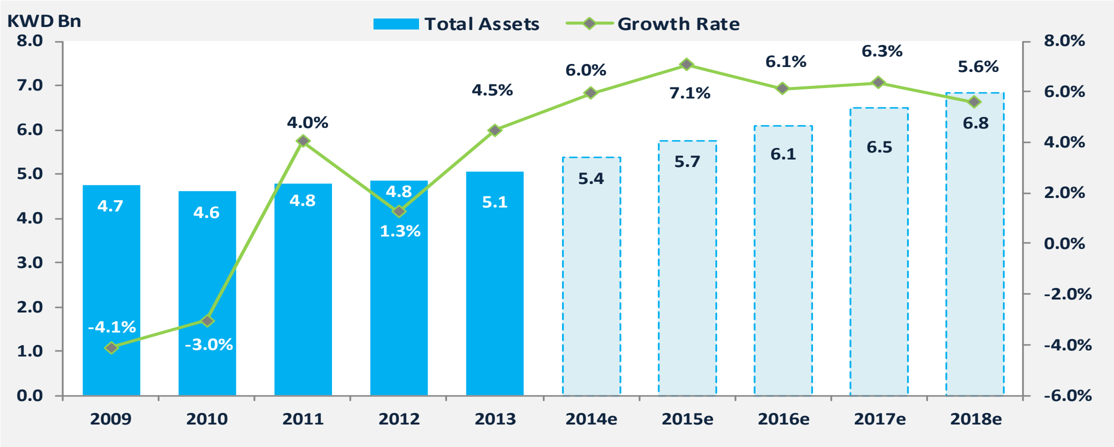
Source: KSE & KAMCO Research (Rebased Index 100)

Asset Structure & Funding Base

Balance Sheet Size

Gulf Bank's balance sheet size grew marginally over the last 5-year period and recorded a CAGR of 0.5%, as compared to a CAGR of 6.3% for the Kuwaiti Banking Sector, to stand at around KWD 5.1 Bn as of Dec-2013; yet further increased to KWD 5.4 Bn as of Sep-2014, to record a growth of around 6%. This marginal growth over the historical period is mainly on the back of the deterioration in the quality of loans portfolio forcing the Bank to increase its provisions reserve. We forecast the Bank's assets to grow at a compounded annual rate of 6.2% over the projected next 5 years to reach KWD 6.8 Bn as of Dec-2018, as we expect an improvement in the Bank's asset quality and recovery in the credit market.

Total Assets - Historical and Expected Growth Tends

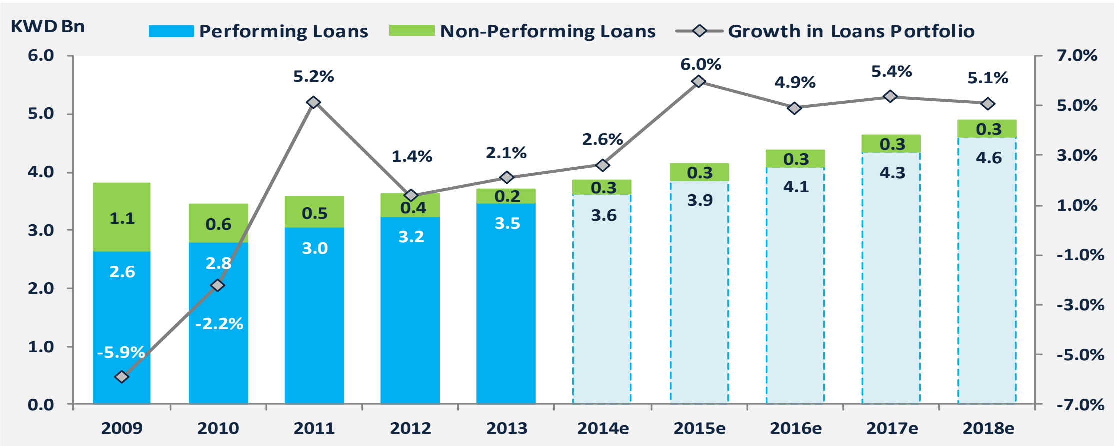


Source: GBK Financials and KAMCO Research

Size and Quality of Loans Portfolio

Given the significant jump in the Bank's non-performing loans during 2009, along with the slowdown in the lending activities, Gulf Bank's loans portfolio stood at KWD 3.7 Bn as of Dec-2013, down from KWD 3.8 Bn at the end of 2008, therefore dropping by a compounded annual rate of 0.6% over the last 5 years. Looking ahead, we forecast Gulf Bank's loans portfolio to grow at a CAGR of 5.7%% over the next 5 years and to reach KWD 4.8 Bn. As well, we expect that the quality of loans to keep on improving gradually in line with our expectation of a recovery in the market conditions and a normalization of default risk, along with the Bank's efforts to strengthen its balance sheet by applying stricter lending policies.

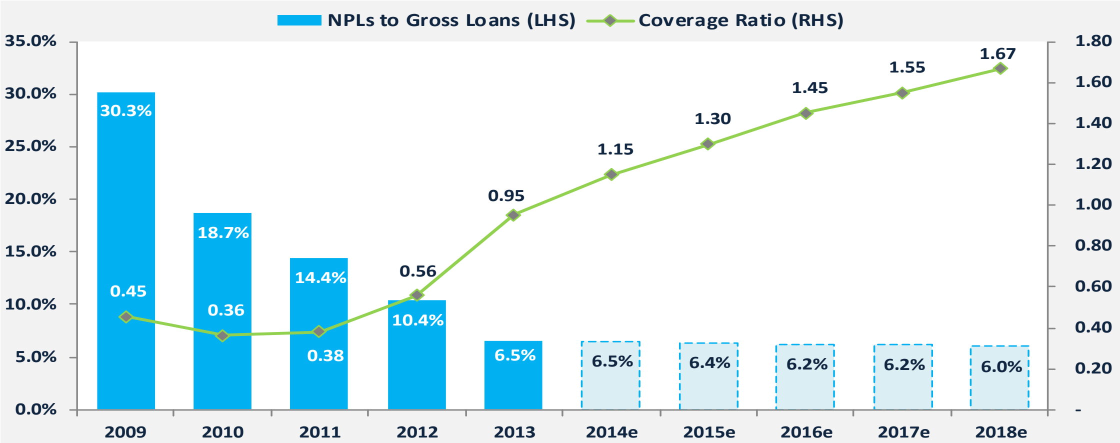
Loans Portfolio - Growth & Quality



Source: GBK Financials and KAMCO Research

NPLs to gross loans ratio reached an extremely high level of 30% by the end of 2009, when the high level of credit default during the financial crisis resulted in a bounce in the amount of NPLs which recorded KWD 1.15 Bn; however the NPLs ratio showed gradual improvements to reach 6.5% as of Dec-2013. On the other hand, given such a huge jump in loans default, the Bank NPLs coverage ratio dropped to a low of 0.36x, however the Bank managed to increase NPLs coverage ratio to almost 1x by the end of 2013. Over the projected horizon, we expect the NPL ratio to drop gradually from its current level to reach 6% by the end of 2018 as the Bank takes additional measures to improve the quality of its loans portfolio. As well, given the high requirements set by the CBK, we believe that the Bank will keep on taking additional provisions in order to improve the coverage ratio which we estimate to gradual rise to reach around 1.7x by 2018.

NPLs and Coverage Ratios

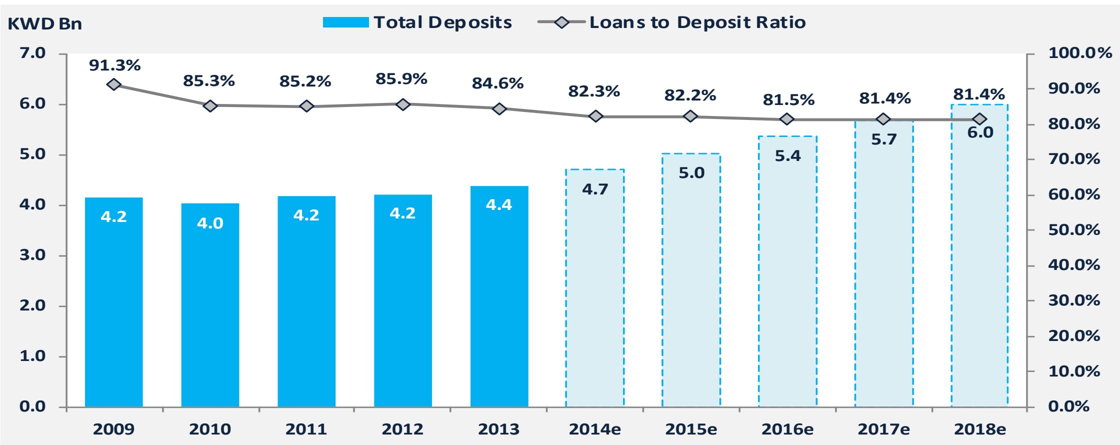


Source: GBK Financials and KAMCO Research

Funding Base and Loans to Deposit Ratio

Gulf Bank's deposit base dropped by a compounded annual rate of around 1.2% over the last five years, to currently stand at KWD 4.6 Bn as of Sep-2014, that is a growth of around 10.4% compared to Dec-2013. Going forward, we expected the growth in total deposits to record a CAGR of 6.5% over the next 5-years and to reach KWD 6.0 Bn by the end of 2018. On the other hand, loan-to-deposit ratio dropped from 91.3% in 2009 to reach 84.6% in 2013, amid more strict lending conditions and high level of risk. Over the next five years, we estimate the ratio of loans-to-deposits to drop marginally and to reach around 81.4% by 2018. The forecasted ratio of loan-to-deposit is mainly based on the maturity profile of the Bank's funding base and the lending ratio set by the Central Bank of Kuwait for each bracket according to maturity.

Total Deposit Base & Loans-to-Deposits Ratio

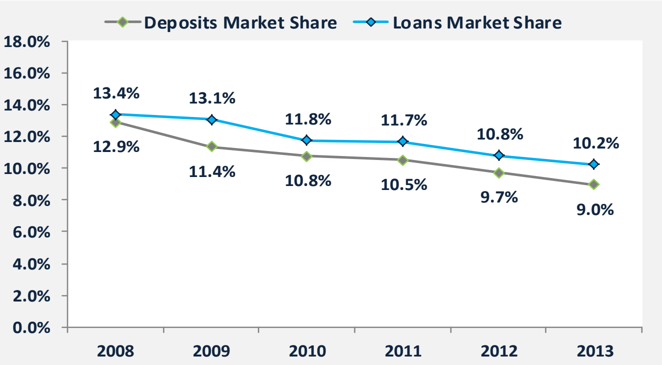


Source: GBK Financials and KAMCO Research

Market Share of Loans & Deposits

The market share of Gulf Bank's loans portfolio has been following a trend since 2008, to currently represent around 10.2% of the Kuwaiti Banking Sector as the Bank's loan portfolio shrank in 2009-2010 and still below the 2008 level. Similarly, market share of deposit have followed the same trend to reach 9.0% in 2013, down from 12.9% in 2008.

Market Share of Loans & Deposits

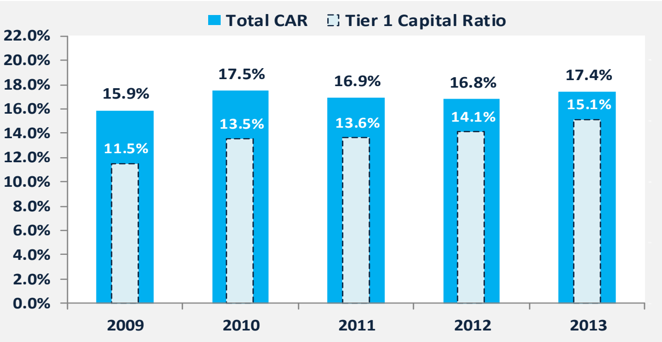


Source: GBK Financials and KAMCO Research

Equity and Capital Adequacy

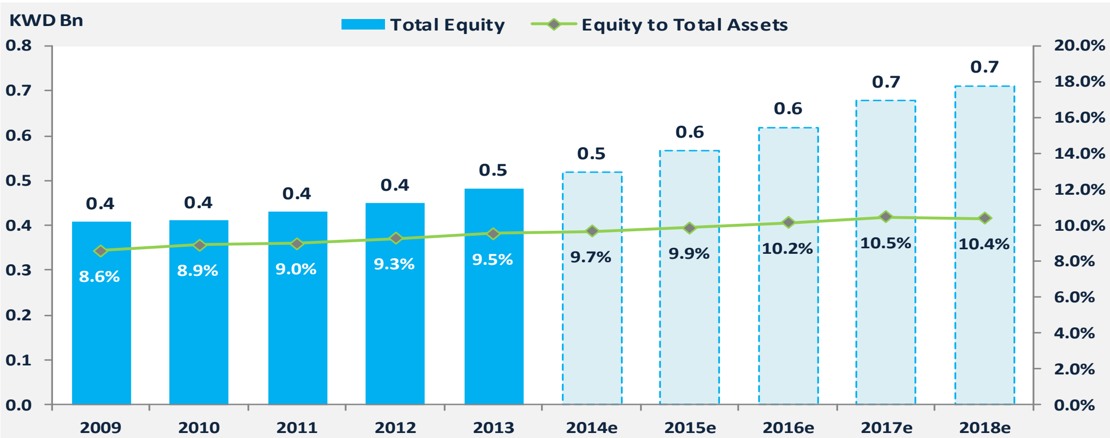
Similar to all other Kuwaiti Banks, Gulf Bank is highly capitalized with the total CAR standing at 17.4% as of Dec-2013. The Bank's equity base has dropped significantly in 2008 when it suffered from huge losses, however, Gulf Bank has set off all the accumulated losses through the right issue in 2009, and therefore maintaining an adequate level of capital with an equity-to-asset ratio at around 9.5%, yet below sector average ratio of 12.3% as of Dec-2013. We forecast the Bank to maintain an adequate level of capital over the forecasted period, fairly above the minimum requirements set by the CBK.

Capital Adequacy Ratios



Source: GBK Financials and KAMCO Research

Shareholders' Equity



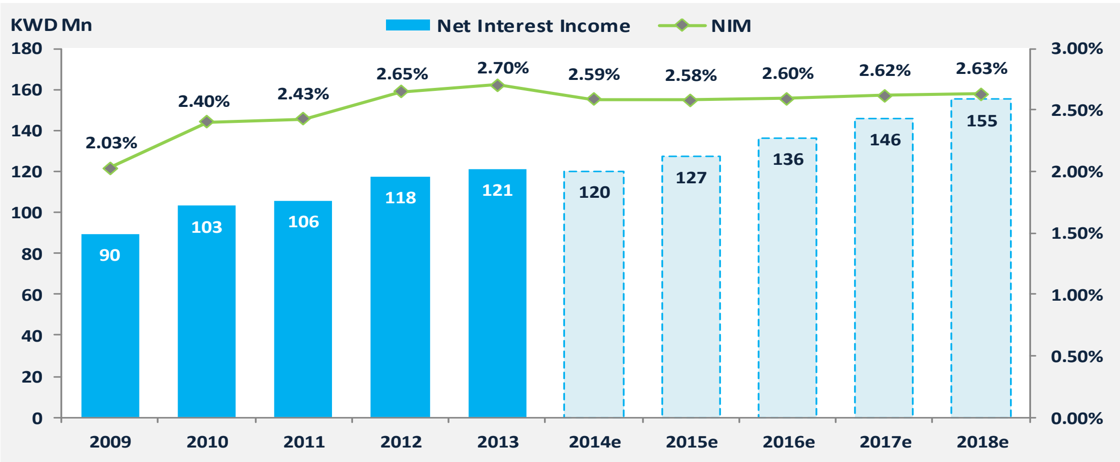
Source: GBK Financials and KAMCO Research

Profitability

Net Interest Income & Margins

In the framework of interest rates hovering at their lowest levels along with pressurized margins and strict lending guidelines to limit the formation of NPLs, Gulf Bank's Net Interest Income (NII) grew at a compounded rate of 0.5% over the last five years after the drop seen in 2009 when NPLs ratio jumped to 30%. On the other hand, Net Interest Margin (NIM) has been showing improvements since 2009, as the Bank not only managed to contain the formation of NPLs but also improved the quality of its portfolio. Having said that, NIM improved from 2.03% in 2009 to reach 2.7% in 2013, however still below the sector's average NIM of 3.30%. Looking ahead, we estimate the growth in NII to pick-up over the next 5 years to reach KWD 155 Mn by the end of 2018, which is a CAGR of 5.0%. The growth in NII will be driven by higher lending volume, while we expect NIM to average around 2.6%.

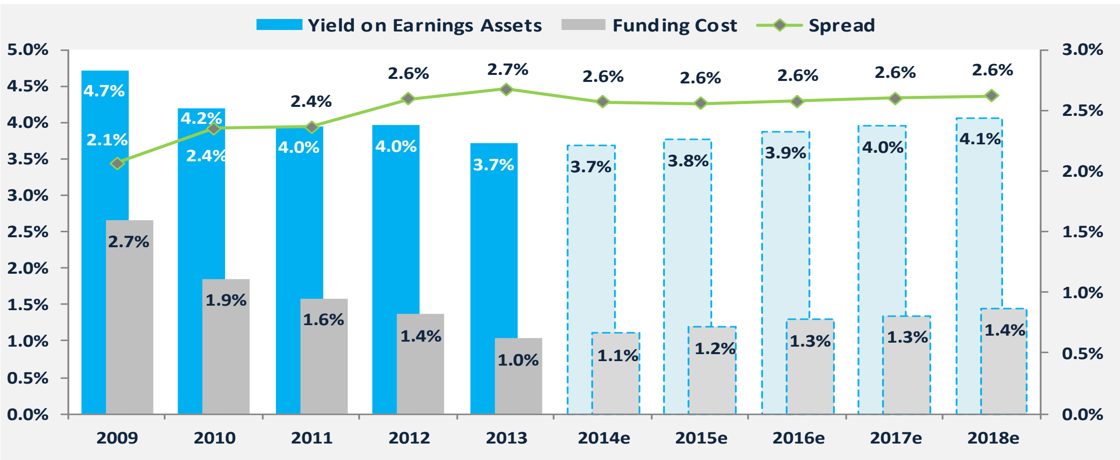
Net Interest Income & Margins



Source: GBK Financials and KAMCO Research

Moreover, interest spread experienced the same trend, improving from a low of around 2.1% during 2009, to reach 2.7% in 2013. Despite the declining interest rates, Gulf Bank improved spread owes to the improvement in the quality of loans portfolio and the reduction in NPLs. The Bank's yield on earning assets and funding cost dropped at the same pace or by around 360 bps. Over the forecast horizon, we anticipate a marginal improvement in interest rates and thus higher yield on earnings assets and funding cost which we estimate at 4.1% and 1.4%, respectively, in 2018; while we believe the spread will be around 2.6%.

Major Profitability Margins



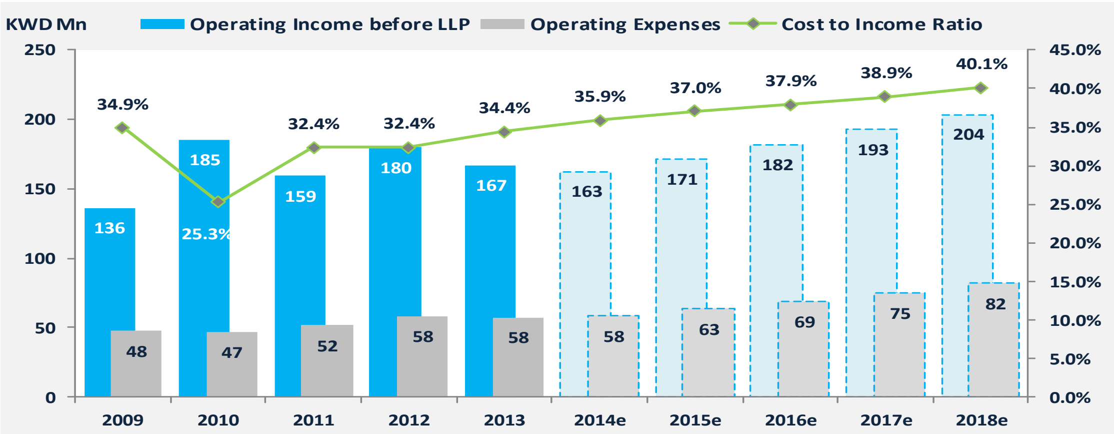
Source: GBK Financials and KAMCO Research

Operating Income and Provisions for Loan Losses

Following the huge losses from dealing in derivate instruments, Gulf Bank's operating income dropped by more than half in 2008, to then grow at a compounded annual rate of 5.2% in 2009-2013, amid subdued economic conditions across regional and global economies, and record KWD 167 Mn during FY 2013. Such a marginal growth in operating income relative to the pre-crisis outstanding growth levels owes mainly to lower interest margins, lower investment income as well as lower growth in core business activities. Moreover, over the 9M-2014 period, Gulf Bank operating income dropped by around 3.1% to record KWD 120 Mn, compared to KWD 124 Mn recorded during 9M-2013. On the other hand, Gulf Bank's operating expenses increased at a CAGR of 6.1% in the middle of an increasingly inflationary cost environment during the last 5 years. Accordingly, cost to income ratio stood at 34.4% in 2013, quiet below the sector average ratio of 43.1% in 2013.

Looking ahead, we forecast operating income to grow at a compounded annual rate of 4.0% as margins and spreads increase and as equity markets recovers gradually; while on the other hand we assume a CAGR of 7.3% in operating expenses taking into consideration the Bank's expansionary strategy and the expected inflation level over the next 5 years.

Operating Efficiency

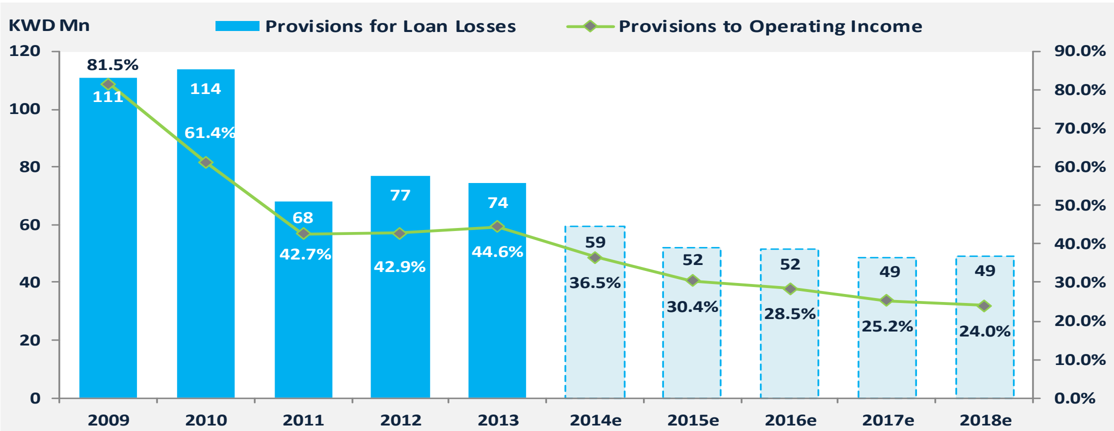


Source: GBK Financials and KAMCO Research

Provisions for Loan Losses

As it is the case for most of the local and regional Banks, loan loss reserve was and remains the key concern for Gulf Bank after the hike seen in NPLs since the financial crisis in 2008. Accordingly, with the high level of provisions taken during the last 5-year period, the Bank was able to increase its coverage ratio up to 100% of NPLs as of Dec-2013.

Operating Income & Provisions for Loan Losses



Source: GBK Financials and KAMCO Research

In relative terms, the amount of provisions taken by Gulf Bank since 2009 consumed on average more than half of the Banks' Operating Income. Looking ahead, given the level of NPLs coverage and the high amount of NPLs relative to loans portfolio, we believe that Gulf Bank will keep on taking additional provisions yet cut down the amount gradually with the improvement in the Bank's asset quality and coverage and as default risk normalizes.

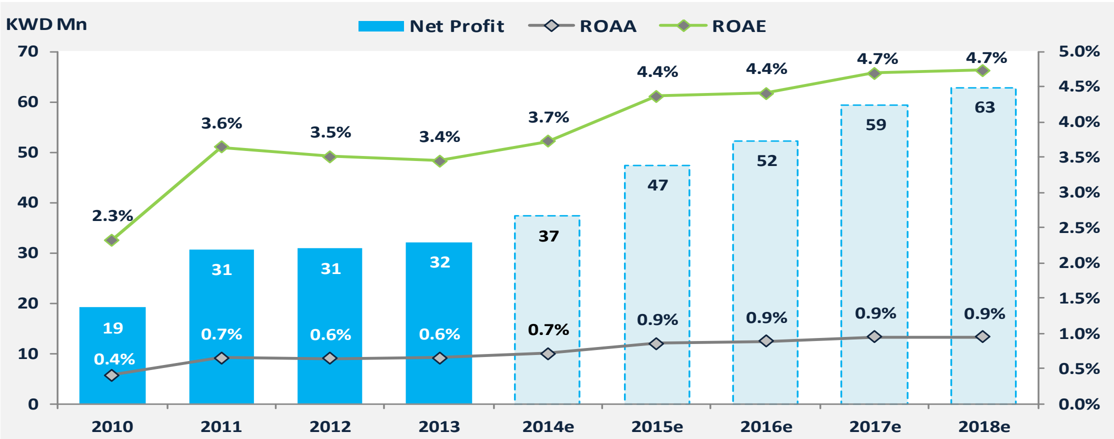
Bottom Line Results & Key Profitability Ratios

Gulf Bank's Net Profit is still at its lowest levels after the losses suffered in 2008 and 2009 on the back of the high amount of provisions and impairments that the bank took over the period, along with a low investment income and a challenging operating environment affecting the core revenues of the bank. On the other hand, the 9M-2014 results showed an increase in Net Profit of 10.2% as compared to last comparable period, to record KWD 26.5 Mn, owing in big part to recovery in loan losses.

Moreover, the banks' core profitability ratios, ROAA and ROAE are at their lowest levels standing at 0.6% and 3.4%, respectively, equivalent to last four years average, and way below the sector average ratios of 1.1% and 8.7%, respectively.

Going forward, we estimate Net Profit to reach KWD 63 Mn in 2018, that is a CAGR of 14.3%. Therefore, we forecast both ROAA and ROAE to gradually improve to reach 0.9% and 4.7% in 2018.

Net Income & Key Profitability Measures



Source: GBK Financials and KAMCO Research

Valuation & Recommendation

"Outperform" rating with a Price Target of KWD 0.351 representing an upside potential of 21.0%

We have valued the Bank using relative valuation based on Price to Book Value Multiple given that the Dividend Discount Model (DDM) is not applicable in the case of Gulf Bank as no dividend has paid over the last 6 years and as we do not expect the Bank to distribute cash dividend over the coming 3 years. Accordingly we estimate the fair value to be KWD 0.351 per share.

Relative Valuation

For peer-based valuation, we have used the forward price to book value based on the 2015 expected Net Profit and the current market capitalization.

Company	Country	M.Cap USD Mn	PE (x) 2015e	PB (x) 2015e
Qatar National Bank	Qatar	40,734	12.64	2.26
National Commercial Bank	Saudi	31,739	15.03	2.41
Al Rajhi Bank	Saudi	23,659	11.00	1.98
First Gulf Bank	UAE	17,944	10.91	2.01
National Bank of Kuwait	Kuwait	14,923	10.83	1.62
National Bank of Abu Dhabi	UAE	17,343	11.04	1.64
Saudi British Bank	Saudi	14,951	12.25	1.93
Riyad Bank	Saudi	14,253	11.38	1.42
SAMBA	Saudi	13,112	9.63	1.21
Kuwait Finance House	Kuwait	11,100	14.62	1.62
Emirates NBD	UAE	13,013	8.14	1.16
Abu Dhabi Commercial Bank	UAE	11,136	9.35	1.64
Arab National Bank	Saudi	8,293	10.38	1.34
Burgan Bank	Kuwait	3,234	9.77	1.60
Commercial Bank of Kuwait	Kuwait	2,943	11.50	1.35
Bank Muscat	Oman	3,492	7.38	0.91
		241,870	**11.34**	**1.73**

Source: KAMCO Researech & Bloomberg

Recommendation

Based on our valuation, the Bank is currently trading at a 17.4% discount to our relative fair value estimate indicating an "**Outperform**" rating following KAMCO's recommendation scale and a price target of KWD 0.351 per share representing an upside potential of 21.0% on the stock.

Financial Indicators

Balance Sheet (KWD Mn)	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Assets								
Cash and Cash Equivalents	371	483	533	814	907	1,015	1,136	1,221
Net Loans & Advances	3,368	3,415	3,487	3,578	3,791	3,978	4,191	4,404
Investment Securities	106	122	124	111	119	126	133	141
Other Assets	941	826	921	863	929	978	1,024	1,080
Total assets	**4,786**	**4,847**	**5,065**	**5,366**	**5,746**	**6,097**	**6,484**	**6,846**
Liabilities								
Customer Deposits	3,330	3,248	3,326	3,619	3,945	4,280	4,601	4,923
Other Liabilities	1,025	1,150	1,255	1,228	1,235	1,198	1,205	1,212
Total liabilities	**4,356**	**4,397**	**4,582**	**4,847**	**5,179**	**5,478**	**5,806**	**6,134**
Shareholders' Equity								
Share capital	251	263	276	290	290	290	290	290
Share premium	153	153	153	153	153	153	153	153
Other Reserves	26	33	54	76	123	176	235	268
Total Shareholders Equity	**430**	**449**	**483**	**519**	**567**	**619**	**678**	**712**
Minority Interest	-	-	-	-	-	-	-	-
Total liabilities and equity	**4,786**	**4,847**	**5,065**	**5,366**	**5,746**	**6,097**	**6,484**	**6,846**

Income Statement (KWD Mn)	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Interest & Financing Income	172	176	167	171	186	204	220	240
Interest & Financing Expenses	(66)	(59)	(45)	(51)	(59)	(67)	(74)	(84)
Net Interest & Financing Income	**106**	**118**	**121**	**120**	**127**	**136**	**146**	**155**
Net Fees & Commission Income	29	29	26	27	28	28	29	29
Investment Income	8	6	3	6	6	6	7	7
Other Income	17	27	16	10	10	11	11	12
Total Non-Interest Income	**53**	**62**	**46**	**42**	**44**	**45**	**47**	**48**
Total Operating Income	**159.2**	**180**	**167**	**163**	**171**	**182**	**193**	**204**
Provisions Expenses & Impairments	(76)	(89)	(76)	(65)	(58)	(58)	(55)	(56)
Operating Expenses	(52)	(58)	(58)	(58)	(63)	(69)	(75)	(82)
Profit before Taxation & Minority Interest	**32**	**32**	**34**	**39**	**50**	**55**	**62**	**66**
Taxation & BOD Remunerations	(1.5)	(1.6)	(1.7)	(1.9)	(2.4)	(2.6)	(2.9)	(3.1)
Net Profit Attributable to Shareholders	**31**	**31**	**32**	**37**	**47**	**52**	**59**	**63**
EPS (KWD)	**0.012**	**0.011**	**0.012**	**0.013**	**0.016**	**0.018**	**0.020**	**0.022**

Cash Flow (KWD Mn)	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Net Cash From Operating Activities	118	150	52	271	103	118	132	124
Net Cash (used in) from Investing Activities	(26)	(25)	5	10	(10)	(10)	(10)	(10)
Net Cash (used in) from Financing Activities	(1)	(11)	(7)	(1)	-	-	-	(30)
Net Change in Cash & Short-term Funds	90	113	50	280	93	108	121	84
Net Cash at end of the year	**371**	**483**	**533**	**814**	**907**	**1,015**	**1,136**	**1,221**

Source : KAMCO Research and Gulf Bank

Key Financial Ratios

Key Ratios	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Profitability Ratios								
Return on Average Assets	0.65%	0.64%	0.65%	0.72%	0.85%	0.88%	0.94%	0.94%
Return on Average Equity	3.64%	3.51%	3.45%	3.72%	4.37%	4.41%	4.69%	4.73%
Net Interest Income/ Total Income (pre-provisions)	66.5%	65.5%	72.7%	74.0%	74.4%	75.0%	75.7%	76.2%
Fees and Commissions/ Total Op. Income	34.3%	31.5%	28.6%	27.2%	24.3%	22.8%	20.9%	19.8%
Non-Interest Income/ Total Income (pre-provisions)	33.5%	34.5%	27.3%	26.0%	25.6%	25.0%	24.3%	23.8%
Dividend Payout Ratio	-	-	-	-	-	-	50.0%	50.0%
Operating Profit Growth Rate (y-o-y)	60.6%	1.2%	4.1%	15.9%	27.1%	10.1%	13.7%	5.7%
Total Provisions to Operating Profits	42.7%	42.9%	44.6%	36.5%	30.4%	28.5%	25.2%	24.0%
Margins & Spreads								
Net income/ Revenues	17.8%	17.5%	19.3%	21.8%	25.5%	25.7%	27.0%	26.2%
Operating Profit / Revenues	18.6%	18.4%	20.3%	22.9%	26.8%	26.9%	28.3%	27.5%
Interest Expense to Interest Income	38.6%	33.2%	27.2%	29.8%	31.5%	33.0%	33.8%	35.2%
Yield on Average Earnings Assets	3.95%	3.96%	3.71%	3.68%	3.77%	3.87%	3.95%	4.06%
Funding Cost	1.59%	1.36%	1.03%	1.11%	1.21%	1.29%	1.35%	1.44%
Net Spread	2.36%	2.60%	2.68%	2.57%	2.56%	2.58%	2.60%	2.62%
Net Interest Margin	2.43%	2.65%	2.70%	2.59%	2.58%	2.60%	2.62%	2.63%
Operating Efficiency Ratios								
Cost to Total Op Income	32.4%	32.4%	34.4%	35.9%	37.0%	37.9%	38.9%	40.1%
Staff Expense to Total Op. Income	20.1%	19.1%	23.7%	26.8%	28.1%	29.1%	30.3%	31.6%
Cost to Average Total Assets	1.10%	1.21%	1.16%	1.12%	1.14%	1.16%	1.19%	1.23%
Liquidity Ratios								
Net Loans to Interest Earnings Assets	75.8%	76.7%	76.9%	75.0%	74.3%	73.5%	73.0%	72.8%
Gross Loans to Customer Deposits	107.0%	111.6%	111.7%	106.9%	104.8%	102.1%	100.7%	99.4%
Gross Loans to Total Deposits	85.2%	85.9%	84.6%	82.3%	82.2%	81.5%	81.4%	81.4%
Gross Loans to Total Assets	74.5%	74.8%	73.4%	72.1%	71.9%	71.7%	71.4%	71.5%
Due from Banks to Due to Banks	2.3%	3.4%	1.3%	2.1%	3.6%	3.8%	4.0%	4.2%
Credit Quality Ratios								
Non-Performing Loans / Gross Loans	14.4%	10.4%	6.5%	6.5%	6.4%	6.2%	6.2%	6.0%
Loan-Loss Reserve / Gross Loans	5.5%	5.8%	6.2%	7.5%	8.3%	9.0%	9.5%	10.0%
Loan-Loss Reserve / Non-perofrming Loans (Coverage)	0.38	0.56	0.95	1.15	1.30	1.45	1.55	1.67
Loan-Loss Provision / Total Op. Income	81.2%	84.9%	81.5%	60.9%	46.0%	41.8%	35.4%	33.1%
Capital Adequacy Ratios								
Equity to Total Assets	9.0%	9.3%	9.5%	9.7%	9.9%	10.2%	10.0%	9.9%
Equity to Gross Loans	12.1%	12.4%	13.0%	13.4%	13.7%	14.2%	14.0%	13.9%
Market Data and Valuation Ratios								
Closing Share Price (KWD)	0.510	0.420	0.375	0.290	0.290	0.290	0.290	0.290
Number of Shares (Mn)	2,508	2,633	2,765	2,903	2,903	2,903	2,903	2,903
Market Capitalization (KWD Mn)	1,279	1,106	1,037	842	842	842	842	842
EPS (KWD)	0.012	0.011	0.012	0.013	0.016	0.018	0.020	0.022
Book Value Per Share (KWD)	0.175	0.176	0.181	0.179	0.195	0.213	0.234	0.245
Dividend Per Share (KWD)	-	-	-	-	-	-	0.010	0.011
Price to Earnings Multiple (X)	41.00	38.18	31.25	22.03	17.74	16.10	14.16	13.40
Price to Book Value Multiple (X)	2.91	2.39	2.07	1.62	1.49	1.36	1.24	1.18
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	3.5%	3.7%

Source : KAMCO Research and Gulf Bank

Note : Forward Valuation ratios are based on current market prices

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