KAMCO Research

Kuwait Corporate Earnings : 2015 - *The Year That Was…*

April-2016

Corporate earnings in Kuwait resilient in 2015 despite oil woes; improved by 2.4% Y-o-Y :

Total net profit of corporates listed on the KSE grew by 2.4% Y-o-Y, as earnings improved to KWD 1,712 Mn in FY 2015, despite falling oil prices that had an apparent impact on the overall economic growth and government budgets. Net profit of Banks drove the increase, as earnings grew 7% Y-o-Y, after growing by over 19% the year before. Consumer Services followed, as total earnings in the sector grew by c.100% (KWD 55 Mn) in FY 2015. The Oil & Gas sector swung to a loss during 2015 due to sectoral headwinds, while Telecoms & Industrials witnessed declines of 20.6% & 15.2% respectively.

ROEs in key sectors stable, barring Telecoms; Banks improve on ROE:

Return on equity (ROE) ratios of KSE listed entities remained stable overall in FY 2015 at 7.5% as against the previous year. On a sectoral basis, key sectors such as Banking, Real Estate and Financial Services were able to improve their ROEs while declines in profitability pushed Telecom and Industrial ROEs lower in 2015. For Banks, the ROE continued to improve to 9.8%, pointing towards higher profitability and value to shareholders.

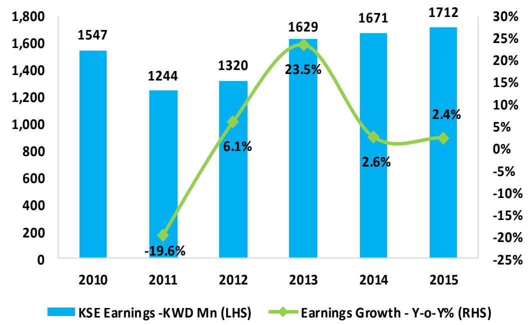
Valuations at 5 year lows; Banking remains most preferred, while Real Estate trades below book:

KSE is trading at historical lows both in terms of P/E and P/B. The KSE was trading at a P/E ratio of 15.3x trailing earnings as of Dec-2015, as the ratio declined steadily over the last 5-6 years, driven by negative investor sentiment. The P/B ratio for the index was 1.2x in 2015, as of Dec-15, which alleviates concerns of being overpriced on a relative and historical basis. Banking remained the most preferred sector by year end 2015, as it traded at a P/B of 1.5x. Real Estate traded at a discount to book value, at 0.8x, as investors continued to remain on the sidelines with respect to the sector.

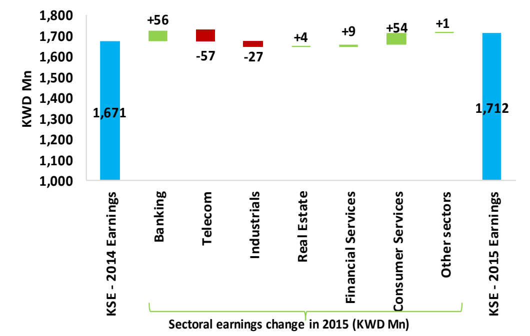
Dividend yields have turned more attractive; Q1-16 corporate earnings to set the tone for 2016:

The decline of over 14.1% in the KSE price index in 2015, has pushed dividend yields higher at 3.6%. Stock prices have slipped by over 7% YTD, which would imply that valuations are more attractive now than Dec-2015. Nevertheless, we expect Q1-16 earnings to set the tone for full year 2016, as we expect corporates to be more cautious on their capex spending, and as they look to optimize cost side initiatives.

KSE Yearly Earnings Trends (2010 -15)



KSE Sectoral Growth Contribution (KWD Mn)



Net Profit/Loss (KWD Mn)	2010	2011	2012	2013	2014	2015	2015 earnings breakup (%)	Y-o-Y(%)
Banks	609	635	656	673	802	858	50.1%	7.0%
Telecom	1141	647	322	311	275	218	12.7%	-20.6%
Industrials	117	91	122	186	181	153	9.0%	-15.2%
Real Estate	-143	-95	88	174	161	166	9.7%	2.6%
Financial Services	-240	-89	-3	62	84	93	5.4%	10.7%
Consumer Services	-50	-10	37	52	0	55	3.2%	17978.1%
Consumer Goods	49	45	36	63	68	72	4.2%	5.1%
Insurance	25	22	30	27	25	37	2.2%	48.7%
Oil & Gas	18	-7	12	19	2	-12	-0.7%	-645.1%
Basic Materials	9	0	5	57	62	66	3.9%	7.4%
Health Care	10	11	11	10	8	1	0.1%	-85.4%
Technology	2	-6	3	-4	3	5	0.3%	89.1%
Kuwait Earnings	1547	1244	1320	1629	1671	1712	100.0%	2.4%

Source: KSE, KAMCO Research

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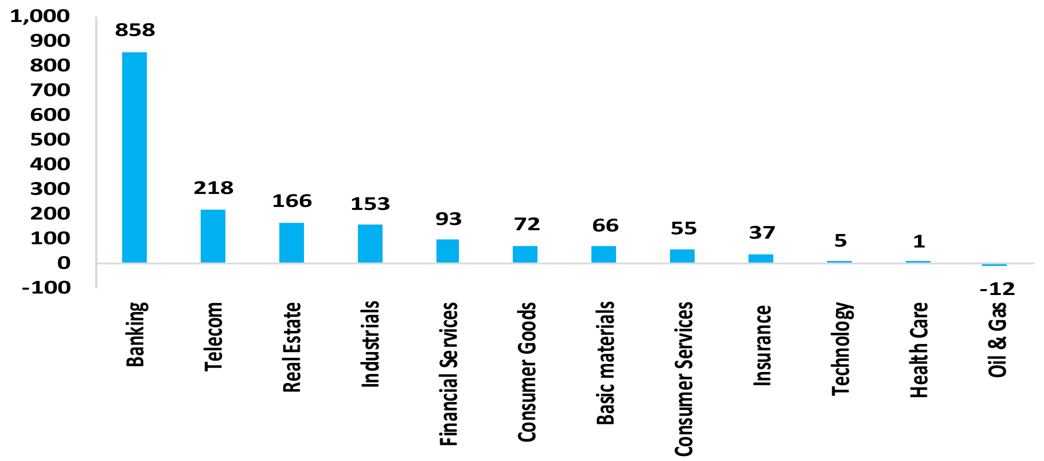
2015 net profits grew 2.4% Y-o-Y…

The total reported net profit by companies listed on the KSE grew by 2.4% Y-o-Y, as close to 90% of the companies released their full year earnings. Net profit improved to KWD 1,712 Mn in FY 2015 from KWD 1,671 MN in the previous year. Overall corporate profitability was able to post moderate growth despite falling oil prices impacting the economy and government budgets.

Net profits of Banks which accounted for more than half of the FY 2015 total corporate profits at the KSE continued to grow, as earnings in the sector grew by 7% Y-o-Y, after growing by over 19% the year before. Consumer Services was another key sector which contributed to the growth in total net profits during the year, as total earnings in the sector grew by KD 55 Mn in FY 2015, after reporting only KWD 0.3 Mn in the previous year. Other key sectors in the index which grew were Financial Services which saw its profits increase by 10.7% Y-o-Y, while Real Estate earnings went up by 2.6% as compared to the previous year. Amongst the larger sectors which constitute the index, Telecoms witnessed a significant drop in earnings, declining by 20.6% as compared to 2014, while Industrials saw double digit declines as well, receding by 15.2% Y-o-Y. The Oil & Gas sector continued to witness deep cuts in corporate profitability from 2014 and swung to a loss of KWD 12 Mn in FY 2015, as the sector witnessed significant headwinds and pressures emanating oil prices declines of over 40% in FY 2015.

KSE Sectoral Earnings - 2015 (KWD Mn)



Source: Kuwait Stock Exchange, KAMCO Research

… but sectoral trends remain mixed

In terms of sectoral earnings trends, 3 out of the top 5 sectors in the index which contribute over 85% of the market capitalization of the index grew Y-o-Y in FY 2015.

Banks added approximately KWD 56 Mn of profits in FY 2015, after adding over KWD 129.5 Mn in 2014. Heavy weight local banks NBK and KFH were able to increase their profitability during the financial year. NBK corporate profits improved by 8% y-o-y, as one-off losses during the year was more than offset by the gain of sale of associate - International Bank of Qatar. The second largest bank in the sector KFH, saw its profits jump 15% as against 2014, driven by net finance income, which reportedly grew from KWD 363.4 Mn in 2014 to KWD 392.8 Mn in FY 2015.

Real Estate, another key sector in the index, improved by 2.6% as compared to the previous year as heavyweight Mabanee was able post stable profits in FY 2015 (+0.7% Y-o-Y) from stable occupancy and rental trends, while NREC and Tamdeen were able to post significant Y-o-Y gains of 47% and 33% respectively. Most larger players in the sector were able to improve their profitability during FY 2015.

The Telecom sector profitability was pulled down by Zain which saw its net profit fall by 20.6% in FY 2015 as compared to the previous year and reported KWD 154 Mn in net profits, as tougher domestic competition, service interruptions and higher costs in Iraq and FX volatility weighed on the bottom line.

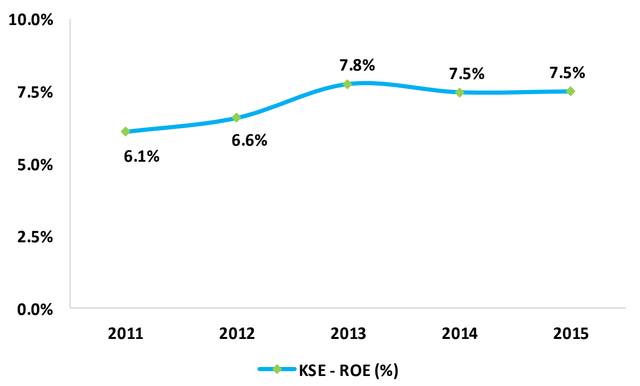
Viva was however able to post a net profit growth of 6.4% Y-o-Y in FY 2015, as the company reported net profits of approximately KWD 43 Mn. Key driver for the improvement in profitability was an increase in customer base, which reportedly grew by 2% Y-o-Y to reach 2.5 Mn subscribers in FY 2015.

In the Industrial space, large cap Agility was able to post a net profit growth of 5% Y-o-Y in FY 2015 at KWD 53 Mn, despite a 6% yearly decline in revenues, as revenue fell at the company' Global Integrated Logistics unit due to challenging market conditions. The largest cement company in the KSE, Kuwait Cement, was able to post an earnings growth of over 11.3% Y-o-Y in 2015.

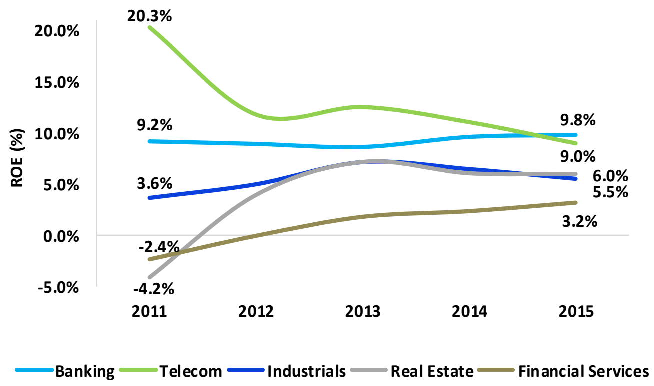
ROEs in most key sectors stabilizing

An analysis of the return on equity ratios of corporates in the KSE, shows that corporate profitability remained stable overall in FY 2015 at 7.5% as against the previous year, while marginally off its five year peak of 7.8% attained in 2013. On a sectoral basis, key sectors such as Banking, Real Estate and Financial Services were able to improve their ROE ratios while lower profitability pushed Telecom and Industrial ROEs lower in 2015. Banking sector ROE improved by 200 bps in 2015 to 9.8%, while the ROE ratio of Financial Services improved by 800 bps, as the sector continues to improve. The Real Estate sector ROE remained stable at 6.0% as against the previous year, as developers look to attain a balance between their rental and development portfolios.

KSE Composite ROE (%)



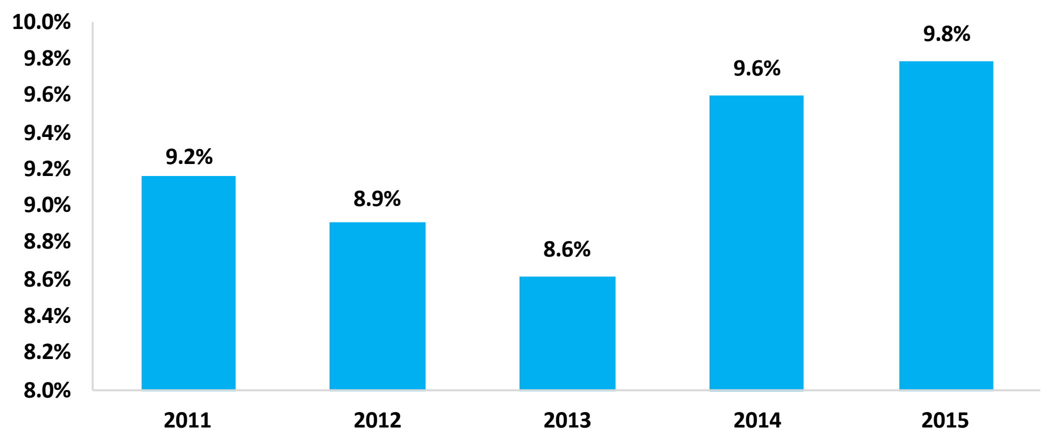
KSE Sectoral ROE Trends



Source: Kuwait Stock Exchange, KAMCO Research

The banking sector has shown the most stable Return on Equity over the past five years with minimal fluctuations. Banking earnings has got a boost from improving economic fundamentals primarily by way of projects announced by the government. Moreover, despite the fall in oil revenues, the government continues to announce new projects in critical sectors. In addition, non-core earnings for banks have shown good improvement recently further supporting the bottom-line.

Banking Sector ROE (%)



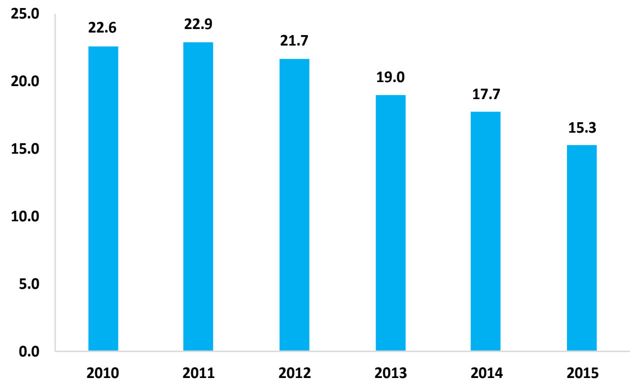
Source: Kuwait Stock Exchange, KAMCO Research

Valuations at 5 year lows

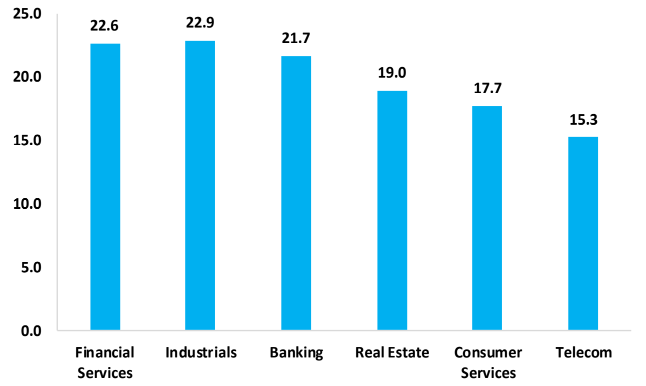
Looking at the market at the end of 2015, based on FY 2015 earnings and balance sheets, the KSE was trading at historical lows both in terms of P/E and P/B. The KSE was trading at a P/E ratio of 15.3x trailing earnings as of Dec-2015, as the ratio declined steadily over the last 5 - 6 years, as investor sentiment remained negative during the period.

On a sectoral basis, despite the recovery in Financial Services in terms of earnings, the sector continues to have the highest P/E at 22.6x, followed by the Industrials sector which saw its earnings decline by over 15% ,and contributed to a higher P/E ratio of 22.9x. At the end of 2015, Telecoms traded at the lowest trailing sectoral P/E ratios as against other key sectors at 15.3x, as the sector fell out of favor from investors, due to sector headwinds while Banking and Real Estate traded at 21.7x and 19.0x its 2015 earnings.

KSE Trailing P/E (x)



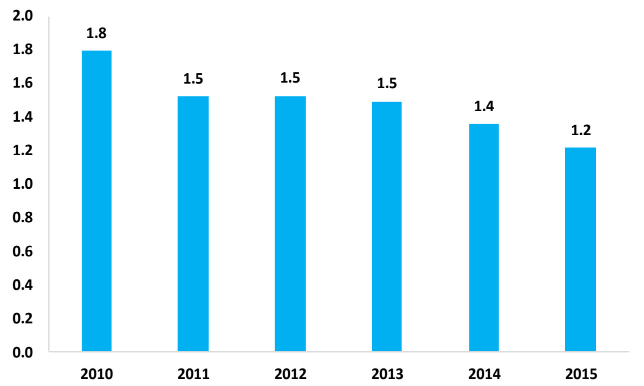
2015 Sectoral P/E (x)



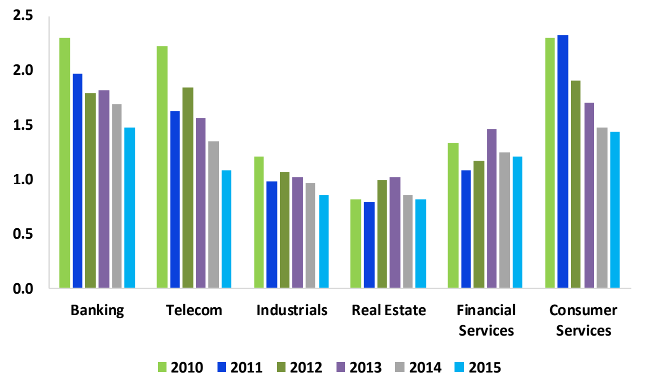
Source: Kuwait Stock Exchange, KAMCO Research

Moreover, we also looked at the P/B ratio to corroborate our view, and to improve our analysis across companies with different capital structures listed in the KSE. Based on our analysis of data from KSE and reported book valued based on company balance sheets, the KSE is trading at historical lows even on a trailing P/B basis. The P/B ratio for the index was 1.2x in 2015 as of Dec-15, which alleviates concerns of being overpriced on a relative and historical basis. The P/B ratio for the index declined from 1.8x in 2010 1.5x in 2013.

KSE Trailing P/B (x)



Sectoral P/B (x)



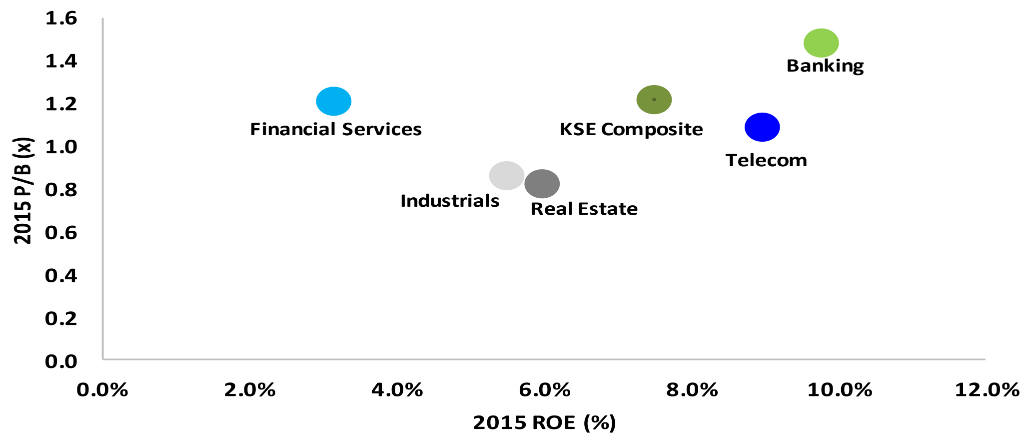
Source: Kuwait Stock Exchange, KAMCO Research

On a sectoral basis, all key sectors such as Banking, Telecoms, Real Estate and Industrials were trading at multi-year low P/B ratios as of Dec - 2015, as market sentiment turned negative in 2015, largely due to oil market concerns. By the end of 2015, Banking was trading at 1.5x P/B and remained more popular amongst investors, while Real Estate was trading at a discount to book value at 0.8x. Stock prices have slipped by over 7% YTD, which would imply that valuations are more attractive now than Dec- 2015.

Banking continues to remain investors' top pick

To analyze how the markets valued different sectors and sectoral profitability, we looked at the relationship between ROE and P/B across sectors. As of end 2015, Banking remained the most preferred sector as per investors as it is priced at a P/B of 1.5x, as investors continued to reward its highest ROE amongst peers (FY 2015: 9.8%). The Telecom sector followed despite a tough 2015, while the market continues to remain on the sidelines to see further progress of the Real Estate and Industrial sectors.

KSE Sectoral ROE vs P/B (x) -2015

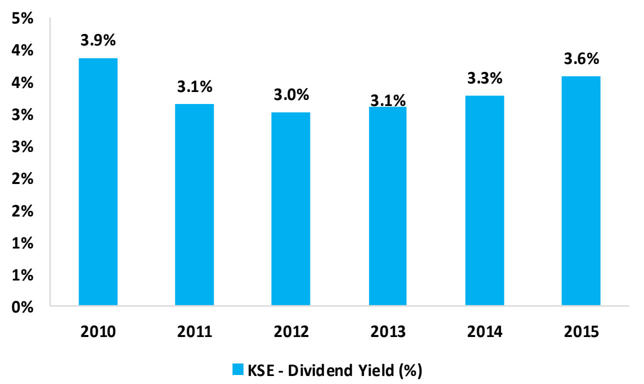


Source: Kuwait Stock Exchange, KAMCO Research

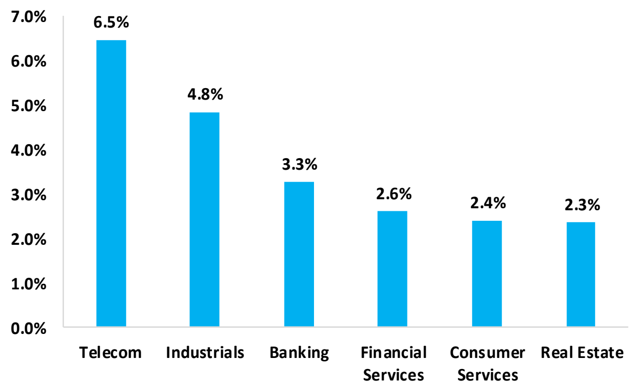
Dividend yields at 3.6% for the KSE

As a result of the decline of over 14.1% in the KSE price index in 2015, dividend yields increased from 3.3% in 2014 to 3.6% at the end of 2015. Dividends yields increased despite a 3% - 4% decline in absolute dividends paid out by companies. Telecom was the most attractive sector on a trailing dividend yield basis at 6.5%, followed by Industrials at 4.8%. Nevertheless the further decline in the KSE price index in 2016, has pushed the dividend yields higher, and the market looks more attractive on a yield basis.

KSE Dividend Yields (%)



Sectoral Dividend Yields (%)



Source: Kuwait Stock Exchange, KAMCO Research

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