

Commercial Facilities Company S.A.K.

Tickers:

FACIL.KW (Reuters)

FACIL KK (Bloomberg)

August, 2008

BUY

Listing:

Kuwait Stock Exchange

Current Price:

KD0.465 (as on Aug 20, 2008)

Key Data

CMP#(fils)	465
EPS*(fils)	69.2
BVPS*(fils)	327.6
P/E	6.7
P / BV	1.4
12M Avg.vol.	374,002
52 week Lo / Hi (fils)	465/657

Source: **Global Research**

#As on Aug 20, 2008

*2008 projected EPS & BV

Highlights

- **Commercial Facilities Company (CFC)**'s net profit for the FY2007 increased by 25.5% to KD36.48mn as compared to KD29.07mn recorded in the previous year. Although the core income of the company declined marginally i.e. income from installment credit, the net profit increased due to a rise in other income. The company's total assets stood at KD381.70mn at the end of 2007, an increase of 3.6% over 2006.
- During 1H08, the net profit of the company was down by 7.3% Y-o-Y and stood at KD15.83mn as compared to 1H07. The decrease in net profit in 1H08 was mainly due to a substantial fall in profit from investments that declined from KD5.90mn in 1H07 to KD0.14mn at the end of 1H08.
- The total assets of the company stood at KD383.63mn at the end of 1H08, representing a marginal increase of 0.5% over end of 2007. The increase in assets, although marginal, was on account of increase in net installment debtors which increased by 2.1% or KD6.85mn in absolute terms.
- Based on the current market price of KD0.465 (as on Aug 20, 2008), CFC stock is trading at 7.2x of its 2008E earnings and 1.4x of its 2008E book value. On 2009E basis, the stock is trading at 6.8x of 2009F earnings and 1.4x of 2009F book value. Based on a Cost of Equity (COE) of 11.75%, the Dividend Discount Model (DDM) value of CFC is KD0.567. On a relative valuation basis, the Company's stock value is KD0.524. Based on the combination of DDM and Relative Valuation method, we recommend a **"BUY"** on the stock with a price target of KD0.559, an upside of 20.1% from current levels.

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Recent Developments

New real estate company

CFC signed a KD2.0mn contract with Al Masar Leasing and Investment Company to acquire 37.2% stake in Priority Leasing Company (fully owned by Al Masar Leasing and Investment Company).

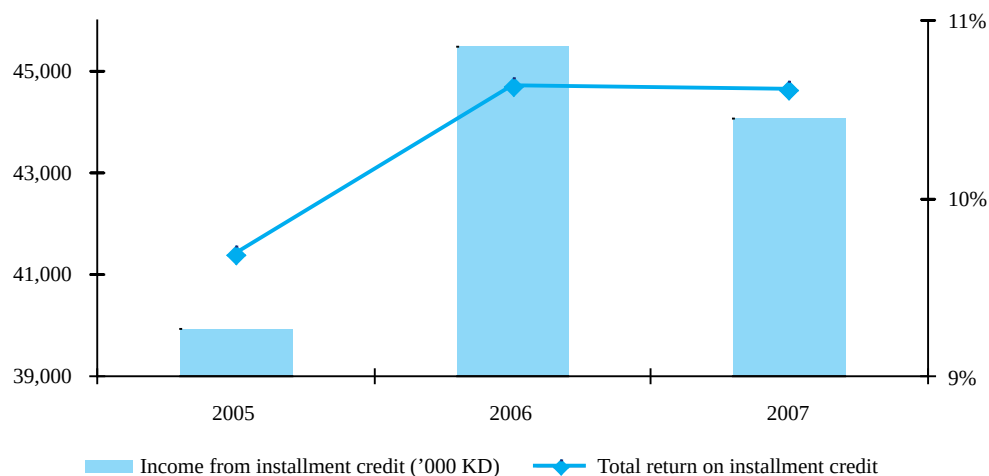
Rating from Capital Intelligence

During June 2007, CFC obtained a rating of A- along with stable outlook from Capital Intelligence. Capital Intelligence noted that the company remains well capitalized and has a stable and well-diversified funding base. The asset quality of the company is good and the operational efficiency is excellent. However Capital Intelligence remarked that they would not want to see the leverage go much higher if this rating is to be maintained.

Financial Performance Review - 2007

Income from installment credit recorded a decline of 3.1% in 2007 and dropped to KD44.07mn as compared to KD45.50mn in 2006. However, the average return from installment credit portfolio remained at 10.6% in 2007 which was same in 2006 as well.

Chart 1: Income from Installment Credit and Return



Source: CFC

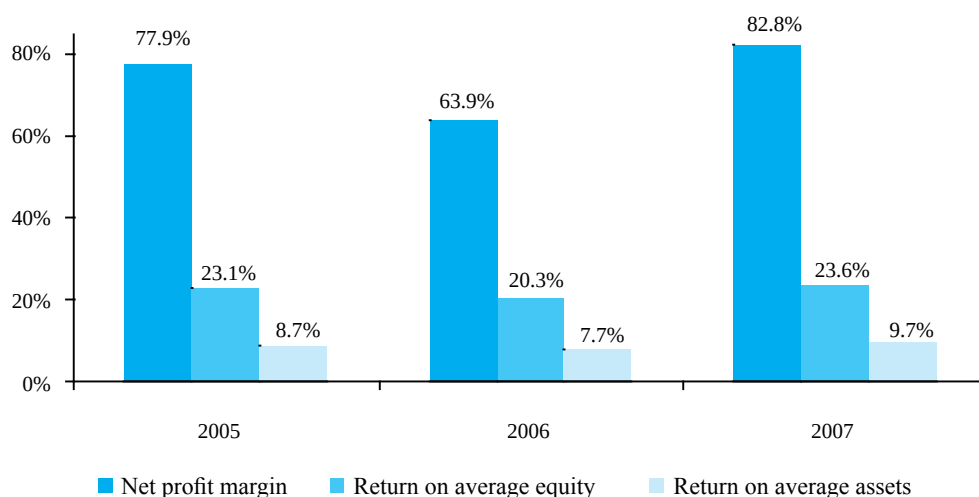
The cost of borrowing increased to 6.8% in 2007, up from 6.5% in 2006. As a result, the interest spread for 2007 declined to 3.9%, down from 4.1% in 2006. The net income from installment credit (after deducting the overall cost of borrowing) reached KD30.05mn in 2007 as compared to KD31.23mn in the previous year, a decline of 3.1%.

Total income records good growth...

The total income which comprise of income from installment credit, income from investments, income from affiliates and other income increased by 22.6% and was KD59.76mn as compared to KD48.69mn in 2006. The increase is mainly on account of an increase in the investment income and other income. The investment income for 2007 was KD5.83mn, up 748.5% from KD0.69mn in 2006. During 2006, the Kuwait market, as measured by Global General Index, was down 9.2% as opposed to a gain of 67.6% recorded in 2005, which resulted in decline in investment income of CFC. However, during 2007 the markets rebounded and recorded a gain of 29.9% and consequently a substantial increase in investment income. Investment income represented 9.8% of the company's total income achieved by the company in 2007 as opposed to 1.4% recorded in the previous year.

Net profit rises...

The net profit increased by 25.5% to reach KD36.48mn in 2007. The rise in the net profit was mainly on account of an increase in profit from investments and other income which gained substantially. As a result, the average return to shareholders increased from 20.3% in 2006 to 23.6% in 2007.

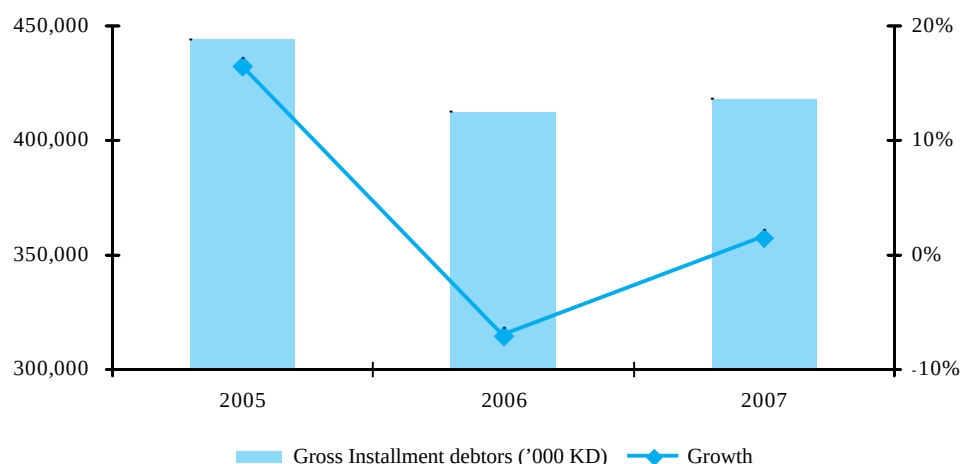
Chart 2: Profitability Ratios

Source: CFC

Assets and liabilities

At the end of 2007, the total assets stood at KD381.7mn, an increase of 3.6% over the previous year. Around 85% of the assets were deployed in the core business (net installment debtors) and about 11% of assets were in investments (both quoted and unquoted investments). There was a marginal increase of 1.3% in net installment debtors which reached KD323.92mn at the end of 2007 as compared to KD319.68mn in 2006.

CFC's gross installment credit portfolio, after declining by 7.1% in 2006, gained by 1.4% in 2007 to reach KD418.30mn. The decline in the portfolio was on account of stricter implementation of credit exposure norms.

Chart 3: Gross Installment Debtors and Growth Rate

Source: CFC

At the end of 2007, shareholder's equity to total assets was 43.1%. On the liabilities side, CFC has continued its strategy of financing mainly through term loans. The company paid back the unsecured bonds payable in 2007 and as a result the total outside financing came down from KD212.31mn to KD192.95mn at the end of 2007. This comprised entirely of term loans which increased by 8.2% over KD178.31mn at the end of 2006 level. The term loans are usually secured with assignments of finance receivables.

The interest rates have been decreasing in recent times. The company has managed to control the cost of funding up to a large extent by increasing their US Dollar exposure because current borrowing cost in US Dollar is cheaper than borrowing in Kuwaiti Dinar. The management has increased the proportion of US Dollar borrowing to 71% of the total borrowing in 2007 as compared to 67.0% in 2006. However until 1H07 the interest rates had been increasing and consequently the average borrowing cost has gone up in 2007 as compared to 2006. The average weighted interest rate on Kuwait Dinar loans was 7.4% and US Dollar loans was 5.9% in 2007, as opposed to 7.3% and 6.3% respectively in 2006. The company's financing operations during the year included new financing lines amounting to KD39mn and US\$210mn.

Non-performing loans

Non-performing loans to gross loans has increased to 8.3% in 2007 from 6.4% in 2006. This is a negative sign implying that the deterioration of quality of loans granted by the company. Company's strict credit criteria for new customers as well as building an efficient and experienced collection and follow-up team had helped the company until recently in maintaining low NPL level. As a policy, the company does not write off debts until there is absolutely no possibility of recovering them. However, during 2007, the amount written off increased substantially to KD41,000 as compared to KD12,000 written off in 2006. With NPL increasing by KD8.30mn and only KD3.46mn additional provided in provisioning during 2007, the NPL coverage ratio came down below 100% and stood at 87.1% for 2007. We expect the company would increase its provisioning and it will again go above 100% in the medium term.

Investment in Associates increases sharply

Investment in associated companies which stood at KD0.45mn in 2006 increased sharply and stood at KD6.44mn. During FY07, the company established a company named 'Tasshilat Real Estate Finance Company' with a capital of KD25mn with CFC's stake at 25%. The company will be engaged primarily in financing real estate activities and till 2007 end had not started its operations.

First Half 2008 Results

There was a marginal Y-o-Y increase of 2.2% in income from installment credit as compared to same period last year. The installment credit portfolio also increased marginally and stood at KD330.77mn at the end of Jun'2008 as compared to KD317.93mn at the end of Jun'2007. However the cost of borrowing declined by 14.0% in line with the declining interest rate environment, as a result the cost of borrowing came down to KD5.93mn as compared to KD6.89mn in 1H-07. Consequently, the gross profit of the company increased by 9.7%.

Table 1: First Half 2008 Results

<i>Amount in KD '000</i>	1H2007	1H2008	% change
Income from installment credit	21,726	22,201	2.2%
Cost of borrowing	(6,893)	(5,929)	-14.0%
Gross profit	14,833	16,272	9.7%
G&A expenses			
Staffing	(1,305)	(1,698)	30.1%
Other	(432)	(457)	5.8%
Operating profit	13,096	14,117	7.8%
Profit / Loss from investments	5,900	135	-97.7%
Provision for Doubtful Debts	(3,311)	(2,655)	-19.8%
Other income	2,072	5,030	142.8%
Profit before KFAS, NLST, Zakat & Directors Remuneration	17,757	16,627	-6.4%
Contribution to KFAS	(178)	(166)	-6.7%
National Labour Support Tax and Zakat	(439)	(573)	30.5%
Director's remuneration	(63)	(63)	0.0%
Net profit	17,077	15,825	-7.3%

Source: CFC

The net profit for the period of KD15.83mn, was down 7.3% compared to 1H07. The decrease in net profit in 1H08 was mainly due to a substantial fall in profit from investments that declined from KD5.90mn in 1H07 to KD0.14mn at the end of 1H08. However, net foreign exchange gain of KD4.13mn recorded during the period partially compensated the substantial fall in income from investments.

The total assets of the company stood at KD383.63mn at the end of 1H08, representing a marginal increase of 0.5% over end of 2007. The increase in assets, although marginal, was on account of increase in net installment debtors which increased by 2.1% or KD6.85mn in absolute terms and investment in associated companies which increased by 31.1% to reach KD8.44mn in 1H08 from KD6.44mn at the end of FY2007. During the period, the company

acquired a 37.24% stake in a company named 'Priority Automobile Company K.S.C.(Closed)' and is equivalent to KD1.999mn and includes a goodwill arising on acquisition of KD0.735mn. The company is incorporated in Kuwait and is engaged primarily in renting and leasing of luxury cars. The company's investments in financial assets fell sharply by 27.7% during the period and came down to KD18.72mn from KD25.89mn at the end of FY07 as the company sold or marked to market some of its investments.

Outlook and Valuation

As per our estimates, the current total consumer credit market size in Kuwait is around KD2.0bn with about 70-75% of the new passenger cars and about 25-30% of the electronic goods being sold on credit.

The market offers sufficient opportunities for growth for players with an organized style of financing that provides ease of transaction and flexibility to the customers through innovative finance programs. The population profile of Kuwait holds lot of promises for the future for established and well managed players in the consumer credit market. About 50% of the Kuwaiti nationals is below 20 years of age . This high potential market will eventually join the work force, and establish a new household, thereby generating demand for cars, consumer goods and other financing.

The high economic growth of Kuwait the over the past few years also had its positive trickle-down effect on most of the sectors of economy including consumer finance sector. With increased wealth and also increased confidence in the economy, people have been spending more on items such as cars and home appliances. We expect the Kuwait economy to grow at a healthy rate over the next few years and this should continue to have positive effect on the consumer finance industry.

Based on the current market price of KD0.465 (as on Aug 20, 2008), CFC stock is trading at 7.2x of its 2008E earnings and 1.4x of its 2008E book value. On 2009E basis, the stock is trading at 6.8x of 2009F earnings and 1.4x of 2009F book value. Based on a COE of 11.75%, the DDM value of CFC is KD0.567. On a relative valuation basis, the Company's stock value is KD0.524. Based on the combination of DDM and Relative Valuation method, we recommend a **"BUY"** on the stock with a price target of KD0.559, an upside of 20.1% from current levels.

BALANCE SHEET

<i>Amount in KD '000</i>	Commercial Facilities Company						
	2005	2006	2007	2008 F	2009 F	2010 F	2011 F
Cash & cash equivalents	1,621	6,810	2,102	3,276	5,719	3,665	4,135
Quoted Investments (Held for trading)	15,425	16,157	25,887	24,593	25,822	27,113	28,469
Other receivables & advances	1,005	2,362	2,650	2,915	3,119	3,275	3,439
Gross Installment debtors (GID)	443,958	412,398	418,304	451,768	483,392	517,230	553,436
Less Deferred Income	(72,710)	(65,880)	(64,090)	(72,283)	(77,343)	(82,757)	(88,550)
GID Less Deferred Income	371,248	346,518	354,214	379,485	406,049	434,473	464,886
Less : Provision	(26,007)	(26,841)	(30,297)	(32,256)	(34,514)	(35,844)	(38,353)
Net Installment debtors	345,241	319,677	323,917	347,229	371,535	398,629	426,533
Total Current Assets	363,292	345,006	354,556	378,013	406,196	432,682	462,576
Unquoted investments (Available for sale)	17,625	21,573	17,258	18,984	19,933	20,930	21,976
Investment in affiliates	465	451	6,438	8,691	9,126	9,582	10,061
Gross fixed assets	2,962	2,987	4,943	5,190	5,450	5,722	6,008
Accumulated depreciation	(1,367)	(1,449)	(1,495)	(1,651)	(1,814)	(1,986)	(2,166)
Net fixed assets	1,595	1,538	3,448	3,539	3,636	3,736	3,842
Total Assets	382,977	368,568	381,700	409,227	438,890	466,930	498,455
Liabilities:							
Due to banks	9,085	195	9,949	7,462	7,536	7,913	8,309
Trade creditors	6,562	3,326	4,013	4,053	4,256	4,469	4,692
Provision for staff indemnity	2,100	2,284	2,777	3,194	3,513	3,864	4,251
Accrued Liabilities	4,770	6,134	7,669	7,822	8,761	9,812	10,990
Current portion of LT loans	74,652	54,715	52,678	64,327	69,473	73,641	77,691
Total Current Liabilities	97,169	66,654	77,086	86,857	93,539	99,699	105,933
Long term loans	109,555	123,591	140,276	150,095	162,103	171,829	181,280
Bonds	34,000	34,000	-	-	-	-	-
Total Liabilities	240,724	224,245	217,362	236,953	255,642	271,529	287,212
Paid-up capital	43,842	48,227	51,120	53,676	53,676	53,676	53,676
Share Premium	1,433	1,433	1,433	1,433	1,433	1,433	1,433
Legal reserve	28,236	31,260	35,055	38,640	42,449	46,533	50,918
Voluntary reserve	28,236	31,260	35,055	38,640	42,449	46,533	50,918
Land Revaluation reserve	107	107	2,042	2,042	2,042	2,042	2,042
Cumulative changes in fair value	7,724	1,844	1,628	977	586	352	211
Foreign currency translation reserve	-	58	34	34	34	34	34
Retained earnings	40,010	39,441	43,982	43,752	46,455	51,265	57,827
Gain on Treasury shares	40	40	47	47	47	47	47
Treasury shares	(7,375)	(9,347)	(6,058)	(6,967)	(5,922)	(6,514)	(5,863)
Shareholder's equity	142,253	144,323	164,338	172,274	183,248	195,402	211,243
Total Equity & Liabilities	382,977	368,568	381,700	409,227	438,890	466,930	498,455

PROFIT & LOSS STATEMENT

	Commercial Facilities Company						
<i>Amount in KD '000</i>	2005	2006	2007	2008 F	2009 F	2010 F	2011 F
Income from installment credit	39,922	45,496	44,072	46,182	50,157	53,815	57,582
Cost of borrowing	(11,701)	(14,258)	(14,027)	(13,757)	(16,140)	(17,737)	(18,710)
Gross profit	28,221	31,238	30,045	32,425	34,017	36,078	38,872
G&A expenses							
Staffing	(2,348)	(2,561)	(3,220)	(3,243)	(3,567)	(3,852)	(4,122)
Other	(712)	(780)	(1,066)	(1,102)	(1,106)	(1,082)	(1,166)
Operating profit	25,161	27,897	25,759	28,080	29,345	31,144	33,585
Profit / Loss from investments	6,278	687	5,829	1,307	3,660	4,804	6,053
Provision for Doubtful Debts	(325)	(846)	(3,497)	(1,959)	(2,258)	(1,330)	(2,509)
Other income	1,246	2,575	9,880	8,424	7,336	6,229	6,717
Income from affiliates	(102)	(72)	(18)	-	-	-	-
Profit before KFAS & Directors Remuneration	32,258	30,241	37,953	35,852	38,084	40,847	43,846
Contribution to KFAS	(323)	(302)	(380)	(359)	(381)	(409)	(439)
National Labour Support Tax and Zakat	(714)	(746)	(967)	(884)	(939)	(1,007)	(1,081)
Director's remuneration	(123)	(126)	(126)	(136)	(143)	(150)	(158)
Net profit	31,098	29,067	36,480	34,473	36,621	39,281	42,169

P&L Appropriation Account:

Op Balance of Retained Earnings	35,420	40,010	39,441	43,982	43,752	46,455	51,265
Net Profit for the year	31,098	29,067	36,480	34,473	36,621	39,281	42,169
Issue of Bonus Shares	-	(4,385)	(2,893)	(2,556)	-	-	-
Trfr to Legal Reserve	(3,226)	(3,024)	(3,795)	(3,585)	(3,808)	(4,085)	(4,385)
Trfr to Voluntary Reserve	(3,226)	(3,024)	(3,795)	(3,585)	(3,808)	(4,085)	(4,385)
Dividend	(15,446)	(19,237)	(21,456)	(24,977)	(26,301)	(26,301)	(26,838)
Trf to P&L on sale of available for sale inv'ts	54	34	-	-	-	-	-
Sale of Treasury Shares	33	-	-	-	-	-	-
Cl Balance of Retained Earnings	44,707	39,441	43,982	43,752	46,455	51,265	57,827

CASH FLOW STATEMENT

<i>Amount in KD '000</i>	Commercial Facilities Company						
	2005	2006	2007	2008 F	2009 F	2010 F	2011 F
Operating							
Profit from Operations	32,258	30,241	37,953	35,852	38,084	40,847	43,846
Depreciation	102	86	74	156	164	172	180
Profit / Loss from Investments	(6,278)	(687)	(5,829)	(1,307)	(3,660)	(4,804)	(6,053)
Interest and other income	(5)	(197)	(225)	(8,424)	(7,336)	(6,229)	(6,717)
Share of profit / loss of associated companies	102	72	18	-	-	-	-
Provision for doubtful debts	325	846	3,497	1,959	2,258	1,330	2,509
Provision for staff indemnity	291	520	552	500	383	422	464
Dividend income	(612)	(1,062)	(1,405)	(1,089)	(1,144)	(1,201)	(1,261)
Foreign currency translation - investment	-	(136)	337	-	-	-	-
Cash From Operating Activities Before WC Changes	26,183	29,683	34,972	27,646	28,748	30,536	32,967
Installment debtors	(40,074)	24,718	(7,737)	(25,271)	(26,564)	(28,424)	(30,413)
Other receivables and advances	(198)	(1,357)	(288)	(1,644)	(1,667)	(1,722)	(1,841)
Trade Creditors and accrued liabilities	2,731	(3,079)	749	194	1,141	1,264	1,401
Changes in working capital:	(37,541)	20,282	(7,276)	(26,721)	(27,089)	(28,881)	(30,853)
Staff Idemnity paid	(32)	(336)	(59)	(83)	(64)	(70)	(77)
Interest received	5	197	225	8,424	7,336	6,229	6,717
Dividends received	612	1,062	1,405	1,089	1,144	1,201	1,261
Cash From Operating Activities	(10,773)	50,888	29,267	10,355	10,075	9,014	10,015
Investing							
Fixed Assets	(116)	(29)	(49)	(247)	(260)	(273)	(286)
Purchase of investments	(6,055)	(15,201)	(22,752)	(1,083)	(2,570)	(2,522)	(2,543)
Proceeds from sale of investments	6,163	5,498	22,826	1,307	3,660	4,804	6,053
(Investment in) /proceeds from associated companies or subsidiaries	-	-	(6,242)	(2,253)	(435)	(456)	(479)
Cash From Investing Activities	(8)	(9,732)	(6,217)	(2,276)	397	1,553	2,745
Financing							
Dividend paid to shareholders	(15,410)	(19,204)	(21,456)	(24,977)	(26,301)	(26,301)	(26,838)
Change in due to banks	7,524	(8,890)	9,754	(2,487)	75	377	396
Change in terms loans	23,123	(5,901)	14,648	21,468	17,154	13,895	13,501
Net purchase of / proceeds from treasury shares	(4,160)	(1,972)	3,296	(909)	1,045	(592)	651
Change in bonds	-	-	(34,000)	-	-	-	-
Cash From Financing Activities	11,077	(35,967)	(27,758)	(6,905)	(8,028)	(12,622)	(12,290)
Net Increase/Decrease in cash	296	5,189	(4,708)	1,174	2,444	(2,054)	470
Cash & Cash Equivalents at the beginning of year	1,325	1,621	6,810	2,102	3,276	5,719	3,665
Cash & Cash Equivalents at end of year	1,621	6,810	2,102	3,276	5,719	3,665	4,135

FACT SHEET

	Commercial Facilities Company						
	2005	2006	2007	2008 F	2009 F	2010 F	2011 F
PROFITABILITY							
Growth in gross installment credit portfolio	16.5%	-7.1%	1.4%	8.0%	7.0%	7.0%	7.0%
Total return on installment credit	9.7%	10.6%	10.6%	10.6%	10.7%	10.8%	10.8%
Net return on installment credit	6.8%	7.3%	7.2%	7.5%	7.3%	7.2%	7.3%
Interest paid to borrowings	5.1%	6.7%	6.9%	6.2%	6.8%	7.0%	7.0%
Interest paid to average borrowings	5.5%	6.5%	6.8%	6.5%	7.0%	7.2%	7.2%
Net Interest Spread	4.2%	4.1%	3.9%	4.1%	3.7%	3.6%	3.6%
Operating profit margin	63.0%	61.3%	58.4%	60.8%	58.5%	57.9%	58.3%
Net profit margin	77.9%	63.9%	82.8%	74.6%	73.0%	73.0%	73.2%
Return on average equity	23.1%	20.3%	23.6%	20.5%	20.6%	20.7%	20.7%
Return on average assets	8.7%	7.7%	9.7%	8.7%	8.6%	8.7%	8.7%
LEVERAGE							
Debt %	61.5%	59.6%	55.3%	56.3%	56.6%	56.5%	55.9%
Equity %	38.5%	40.4%	44.7%	43.7%	43.4%	43.5%	44.1%
Debt to equity ratio (x)	1.60	1.47	1.23	1.29	1.30	1.30	1.27
Interest coverage (over operating profit)	2.2	2.0	1.8	2.0	1.8	1.8	1.8
LIQUIDITY							
Current ratio (x)	1.41	2.09	1.99	1.87	1.88	1.86	1.87
Debt equity ratio (x)	1.60	1.47	1.23	1.29	1.30	1.30	1.27
Total liabilities to equity (x)	2.69	2.55	2.32	2.38	2.40	2.39	2.36
CREDIT QUALITY							
NPL (as a % of Gross Loans)	6.4%	6.4%	8.3%	7.0%	7.0%	6.9%	6.8%
Provision (as a % of Gross Loans)	5.9%	6.5%	7.2%	7.1%	7.1%	6.9%	6.9%
NPL Coverage ratio	92.1%	101.4%	87.1%	102.0%	102.0%	100.4%	101.9%
RATIOS USED FOR VALUATION							
Par value (fils)	100	100	100	100	100	100	100
Number of shares in issue (in '000)	438,420	482,270	511,200	536,760	536,760	536,760	536,760
Market price of the share (fils)*	669	548	543	465	465	465	465
Book value per share (fils)	265.0	268.9	306.2	321.0	341.4	364.0	393.6
EPS (fils)	57.9	54.2	68.0	64.2	68.2	73.2	78.6
P/E	11.5	10.1	8.0	7.2	6.8	6.4	5.9
P/BV	2.5	2.0	1.8	1.4	1.4	1.3	1.2
Cash dividend payout ratio	61.9%	73.8%	68.5%	76.3%	71.8%	68.3%	63.6%
Dividend yield	4.7%	7.1%	8.3%	10.8%	10.8%	11.8%	11.8%

* Market Price for 2008 and subsequent years is as on Aug 20, 2008

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Company	Recommendation	Ticker	Price	Disclosure
Commercial Facilities Company	BUY	FACIL.KW (Reuters) FACIL KK (Bloomberg)	KD 0.465	1,10

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Global Research: Equity Ratings Definitions

Global Rating Definition

Buy	Fair value of the stock is >10% from the current market price
Hold	Fair value of the stock is between +10% and -10% from the current market price
Reduce	Fair value of the stock is between -10% and -20% from the current market price
Sell	Fair value of the stock is < -20% from the current market price

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