KAMCO Research

April 2008

Kuwait Finance House
Equity Research Update



KAMCO إدارة الأصول خدمات مالية | كامكو Asset Management Financial Services

KAMCO Recommendation Scale:

- ***Strong Buy***
- ***Buy***
- ***Hold***
- ***Sell***

Our Recommendation Indicates:

Strong Buy: the stock is undervalued by more than 15% of our Estimated Fair Value.
Buy: the stock is undervalued within the range of 5-15% below our Estimated Fair Value.
Hold: the stock is fairly valued in the market and has a potential to appreciate up to 5%.
Sell: the stock is currently overvalued relative to our Estimated Fair Value.

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KAMCO Research

Kuwait Finance House
Equity Research Update

Kuwait Finance House

April 2008

Kuwait Banking Sector
Research Update
Recommendation: Strong Buy

Reuters Code: KFIN.KW
Current Price: KD 2.860
Fair Value: KD 3.538

Key Financial Facts *(KD million)*

	Dec 06	Dec 07
Total Assets	6,313.8	8,797.9
Net Loans	4,476.7	5,986.1
Customer Deposits	3,729.9	5,361.2
Total Equity	777.8	1,298.8
Total Operating Inc.	402.6	588.6
Net Income	162.0	275.3

Key Ratios *(%)*

	Dec 06	Dec 07
Return on Average Assets	**2.95**	**3.64**
Return on Average Equity	**24.87**	**28.79**
Net Interest Margin	3.67	3.99
Cost/ Income Ratio	43.94	36.62
Liquid Assets Ratio	20.31	18.42
Net Loans/ Total Deposits	93.07	91.42

Share Data 31/03/2008

Current Price *(KD)*	2.860	Fair Value / Share *(KD)*	3.538
Shares Outstanding *(mil.)*	2,058.4	Market Cap. *(KD million)*	5,077.4
52 Weeks High *(KD)*	4.00	52 Weeks Low *(KD)*	2.160
Turnover Year to Date %	31.88	P/E Multiple (x)	21.39

Highlights

- **KFH reported net profits of KD 275.27 million for 2007, up by 69.91% from KD 162 million reported for 2006.**
- **Net Interest Margin for FY 07 reached 3.99%, up by 32 basis points from the 3.67% recorded in FY 06.**
- **Total operating income reached KD 588.6 million for 2007, 46.2% higher compared to 402.62 million reported for 2006.**
- **Customer Deposits to Total Deposits recorded 81.88% as of the end of 2007, up from 77.55% recorded in 2006.**
- **KFH is available at 19.16% discount to our fair value estimate of KD 3.538**

Valuation Snapshot

Our DCF model indicated a value of KD 3.856 per share while the PE and P/B multiples based on the peer group Kuwaiti banking sector indicated a value of KD 2.911 and KD 2.677 respectively.

We used a weighted average of the above valuation models, giving a 70% weight to the DCF method and 15% to each of the P/E and P/B methods to arrive at an estimated fair value of KFH at KD 3.538. KFH is now trading at a 19.16% discount to our estimated fair value, indicating a ***Strong Buy*** following KAMCO's recommendation scale.

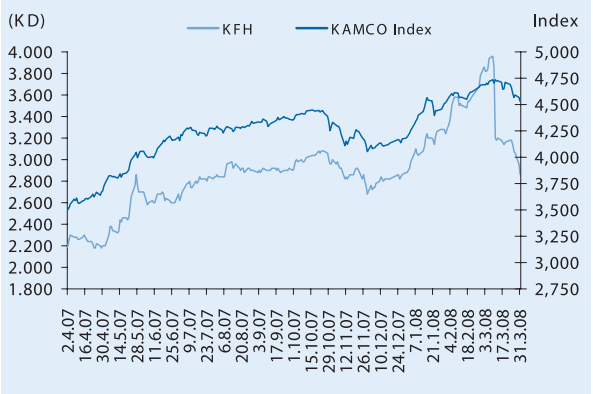


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Note: *Kuwait Finance House is an Islamic financial institution that does not deal with usury (interest) and that abides by the Islamic law (Shari'a) in all of its practices. However, we will use throughout this report terms related to conventional (non-Islamic) banking such as "interest" and "loans" solely for the sake of comparing KFH performance to other conventional banks in the market.*

Report Highlights

Net Profit in 2007 reached KD 275 million, up by 70%.

The year 2007 reflected KFH's continued series of double digit growth for four consecutive years, with net profit surging by 69.91% from 2006 to reach a record KD 275.27 million, higher than the 26.59% average profit growth reported for all listed banks for 2007 (excluding Kuwait International Bank). On the back of solid growth in the local economy, higher oil prices, and rapid growth in bank's loan portfolio, Net interest income increased by 48.43% as of the end of 2007.

Non-Interest income grew by 45%

Backed by considerable gains in bank's investment portfolio and fees and commissions, Non-interest income showed a 44.85% growth in 2007 to reach KD 364.26 million, reflecting a non-interest income to net operating income ratio of 61.9%.

KFH made major acquisitions during the year

Furthermore, KFH worked aggressively to boost its global expansion strategy while reinforcing their status in the current markets. The bank acquired major stakes in six companies and gained from sales of three companies' stakes. The bank also established a company in Morocco and is considering establishing new banks and financial activities in North Africa, South East Asia, and other GCC countries. KFH also opened two new branches during 2007 to increase its base to 44 branches. The bank has also participated in unprecedented deals during the year such as its conjunction with Merrill Lynch Bank to buy electrical power and opening a new portfolio worth USD 1 trillion that deals with global market commodities in conjunction with Goldman Sachs Bank.

For purposes of valuation, we took into consideration the overall macroeconomic landscape and the interest rate environment along with the bank's aggressive expansionary strategy, and updated our financial projections for KFH between 2008 and 2012 to specifically reflect the growing loan and proprietary investment portfolios of the bank.

We value KFH at KD 3.538 per share

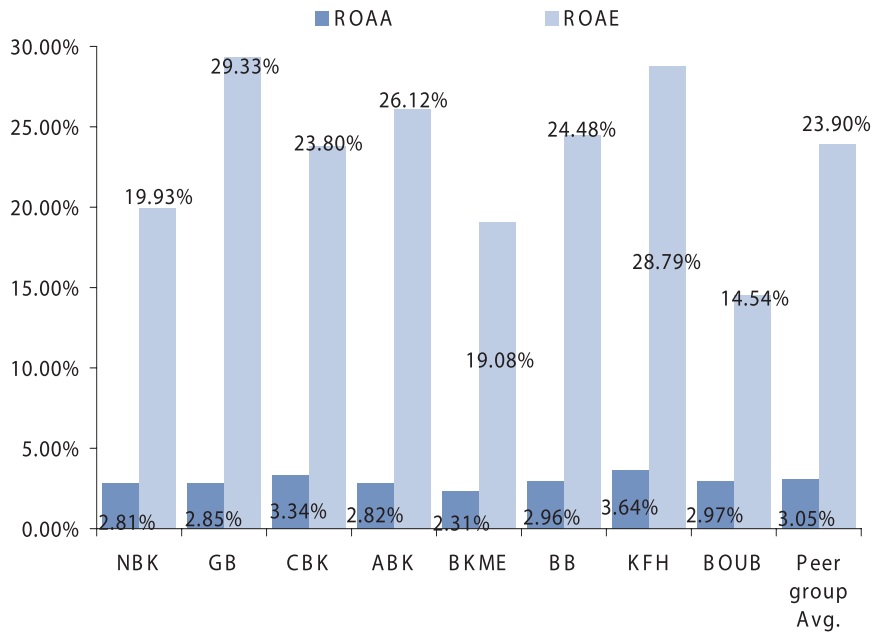
Our estimated DCF value for KFH was KD 3.856 while the Relative Valuation Methods, which used peer group P/E, and P/B analysis, resulted in a fair value per share of KD 2.911 and KD 2.677 respectively. A weighted average of the aforementioned methods resulted in a fair value per share of KD 3.538.

Performance Overview

KFH continued to report solid profits in 2007 and boosted its core profitability ratios...

During 2007, KFH continued to post solid profits, with net income for the year reaching KD 275.27 million. KFH built on its 4-year double digit growth and posted the highest yearly rise of 69.91% compared to KD 162 million reported in 2006. In line with KFH's solid performance, earnings per share for 2007 was higher by 62.75% compared to 2006 and reached KD 0.166. The shareholders of the bank has also met and approved a cash dividend of 65% and issuance of bonus shares of 20%, and as a result the bank's number of shares reached 2.06 billion. Meanwhile, the upbeat performance of the bank's bottom line results drove it's core profitability ratios for the year with the Return on Average Assets (ROAA) and Return on Average Equity (ROAE) reaching 3.64% and 28.79% respectively compared to last year's ratios of 2.95% and 24.87% respectively. In comparison with the peer group's ROAA of 3.05%, KFH commanded the highest ratio and the second highest ROAE compared to the peer group's average of 23.90%.

Chart 1. Return on Average Assets and Return on Average Equity (2007)



Source: Local Banks' Financial Statements (excluding KIB) & KAMCO Research

Interest income to average interest earning assets sharply rose in 2007, driving the net interest income higher.

Net interest income which is equivalent to Income from Murabaha, Istisna'a and Leasing receivables (Interest income), net distribution depositors (Interest expense) recorded a growth rate of 48.43% in 2007 to end the year at KD 224.37 million, following a 103.9% jump in the previous year. Interest income during the year grew by 42.55% to reach KD 466.89 million on the back of a sharp rise in average interest earning assets which stood at KD

5,624 million in 2007 higher by 36% compared to 2006. During 2007, Net interest income grew by 48.4% as the interest income to average interest earning assets sharply rose from 7.95% (2006) to 8.30% (2007) while the funding costs (interest expense to average interest bearing liabilities) stood almost same in 2006 as well as 2007.

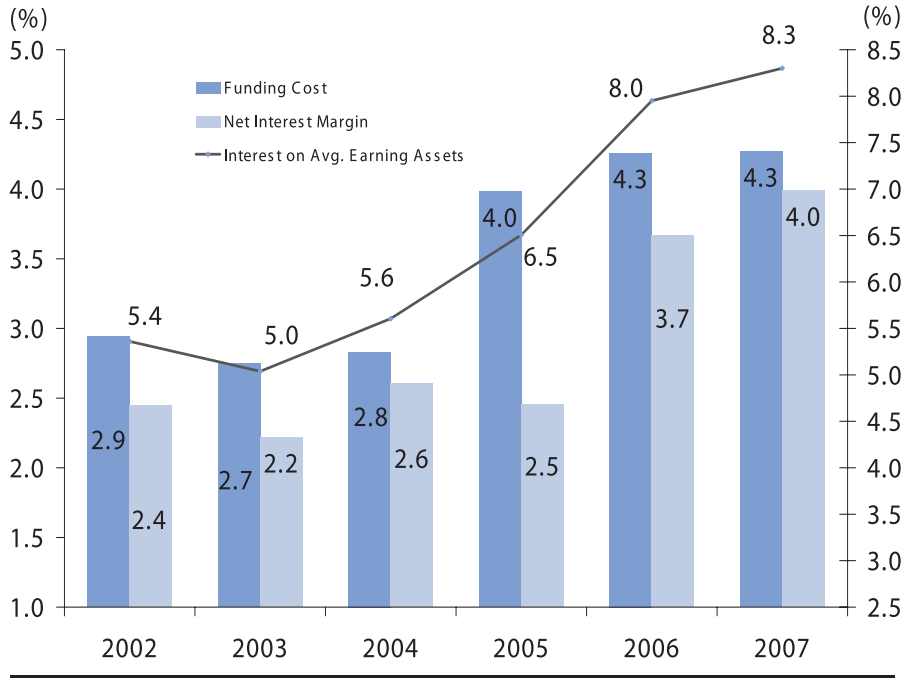
NM was substantially higher in 2007

Net Interest Margin (NIM) was substantially higher in 2007 compared to 2006 at 3.99% backed by the relative growths in average earning assets for the year and net interest income. Compared to the peer group average of 2.71%, KFH commanded the highest NIM among the locally listed banks.

Funding cost was relatively unchanged.

Despite the decrease of interest rates during the year, KFH funding cost which reflects interest expense on customer deposits and deposits from financial institutions very marginally advanced to 4.27% in 2007 from last year's 4.26%, backed by higher average return on investment deposits which led the bank to experience the third lowest funding cost relative to other banks in the local banking sector. Consequently the bank's interest differential increased to 4.03% from 3.69% for the same period.

Chart 2. KFH's Major Profitability Margins (2002-2007)



Source: KFH Financial Statements & KAMCO Research

Attractive returns offered by KFH investment deposits continued to boost deposit base.

The returns offered by KFH on its investment deposits which is considered as the key element in attracting the bank's solid customer base continued to be significantly higher than those offered by local conventional banks on fixed deposits of comparable maturities. However the only difference between the two, is that these returns cannot be known in advance. The

highest return which comes from Mustamera investment deposits comprises 90% of the bank's investment while Al-Sedra and Tawfeer investment deposits account for 70% and 60% of KFH investments respectively. KFH average return on customer deposits, calculated as the distribution to depositors (Interest expense) divided by the average customer deposits, averaged to 5.34% for 2007, up from 5.10% in 2006.

Table 1. Average Returns On KD Fixed Deposits Compared to KFH Investment Deposits

(All figures are in %)	2003	2004	2005	2006	2007
Kuwaiti Market :					
12 Month Fixed Deposits	1.85	2.29	4.63	5.51	4.79
6 Month Fixed Deposits	1.75	2.13	4.46	5.44	4.71
3 Month Fixed Deposits	1.60	1.89	4.29	5.40	4.54
Kuwait Finance House :					
Investment Deposits for an Unlimited Period (Mustamera)	4.40	4.80	6.81	8.46	8.63
Investment Deposits for an Unlimited Period (Al Sedra)	3.42	3.73	5.29	6.58	6.71
Investment Savings Accounts (Tawfeer)	2.93	3.20	4.54	5.64	5.76

Source: KFH Financial Statements, Central Bank of Kuwait Reports, & KAMCO Research

Non-interest income grew by 45%....

Furthermore, KFH held on to its non-interest income uptrend with the support of increases witnessed across all of the bank's non-interest income accounts. Non-interest income in 2007 increased by 44.85% at KD 364.26 million compared to KD 251.46 million in 2006. However, growth in net interest income continued to outpace the growth in non-interest income which translated into a lower contribution of the non-interest income to net operating income ratio to 61.88% from 62.46% in 2006.

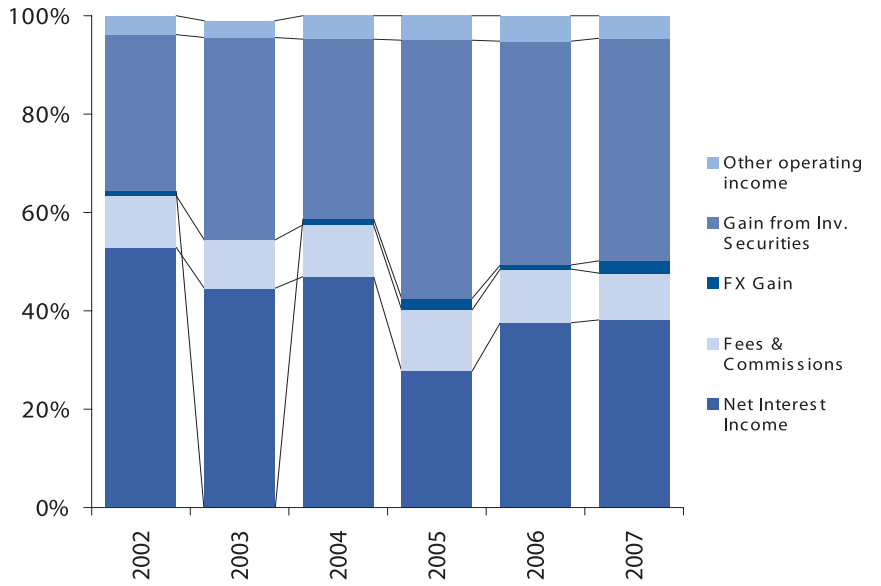
...mainly on account of higher investment income

The Non-interest income increase was largely driven by the increase in investment income reflecting the largest contribution of 73% relative to other non-interest accounts and rising by 45.37% in 2007 to record KD 266.40 million compared to KD 183.25 reported the previous year. The account's rise was mainly attributed to the gains incurred from selling stakes in associate companies which included Munsh'at Real Estate Project Co., Educational Holding Group, and The International Leasing & Investment Co., totaling to a gain on sale of KD 58.29 million for the year. Fees and commissions on the other hand, contributed to around 15% of the non-interest income for the year recorded KD 56.13 million, up by 27.53% from last year, resulting from higher fees generated from bank's funds and new accounts usage. During 2007, KFH expanded their local network through opening two local branches operating through a total of 44 local branches.

Net gain from dealing in foreign exchange and other operating income carried on with last year's double digit growth and surged by 72.40% increasing their contribution to non-interest income to 11.46% from last

year's 9.63%. Both accounts totaled to KD 41.73 million as of December 2007.

Chart 3. KFH Revenue Decomposition (2002-2007)



Source: KFH Financial Statements & KAMCO Research

Operating expenses grew by 22% in 2007.

KFH operating expenses which mainly includes General Administration, Depreciation, and Murabaha & Ijara costs slowed down its trend of high growth rates as it showed a rise of 21.84% during 2007 recording KD 215.57 million, compared to last year's 81.62% growth rate. This was mainly due to disposal of assets which decreased depreciation by 17.23% in 2007 to KD 27.94 million in 2007 compared to KD 33.75 million in 2006. As a result, the bank's cost to net operating income ratio dropped to 36.62% in 2007 from 43.94% in 2006. As for the provision for loan losses, the account grew by 40% during 2007 to reach KD 38.18 million, in line with the 33% growth in the gross loan portfolio.

Balance Sheet Analysis

As of end December 2007, KFH total assets grew by an all time high of 39.34% to reach a record KD 8.798 billion, making the bank the second largest bank in Kuwait after National Bank of Kuwait. Driven by the bank's primary asset component, net loan portfolio, which includes the bank's Receivables, Leased assets, and International Murabaha, increased by 33.72% during 2007 and recorded KD 5.99 billion contributing to 26.56% of the total Kuwaiti banking sector's net loan portfolios.

Total assets were up by 39% in 2007 and recorded KD 8.798 billion...

KFH Receivables which is considered the main constituent of the loan portfolio, comprising 66.62% of net loans continued to reflect the bank's loan book exposure to Banks & financial institutions and Construction & Real estate loans reflecting the market's high demand for these loans. The other two components of the bank's loan portfolio, Leased Assets and International Murabaha continued at an upward momentum and showed a combined total of KD 2.00 billion as of the end of 2007, rising by 17.63% and representing around 33.38% of the net loan portfolio of the bank.

...while total loans grew by 33.72% for the same period.

KFH's quality of loan portfolio remains to be one of the best in the local banking sector with non-performing loans in 2007 reaching KD 109.18 million, 9.19% lower than that of 2006 and constituting 1.77% of the bank's gross loan portfolio. Loan loss reserves followed the same downtrend, dropping by 4.17% during 2007 to post KD 170.14 million, thereby improving the loan loss reserves to gross loan ratio to 2.76% from 3.83% in 2006.

Quality of loan portfolio continued to be one of the best.

KFH investment portfolio which is mainly composed of mutual funds and managed portfolios in addition to associated companies followed a strong uptrend reflecting the bank's investment strategy to further diversify its revenue streams. KFH plans to establish new banks and financial activities in North Africa such as Algeria and Tunis, South East Asia such as China and India, and other GCC countries. During 2007, KFH in conjunction with Merrill Lynch bought electrical power from a British power company and offered a new portfolio that deals with the global market for commodities that is worth USD 1 trillion in conjunction with Goldman Sachs. Furthermore, during 2007, KFH's investment portfolio included major strategic acquisitions mainly through a subsidiary reflected a fair value of around KD 95 million. As of 31 December 2007, investments in associates include:

1. United Capital Bank (40%)
2. Kuwait Energy Co. (41.9%)
3. Sokouk Exchange Center-Tadawul (30%)
4. Sudan Airways Co. (49%)
5. Sukuk Holding Co. (27%)
6. Arabian Sea Real Estate Co. (20%).

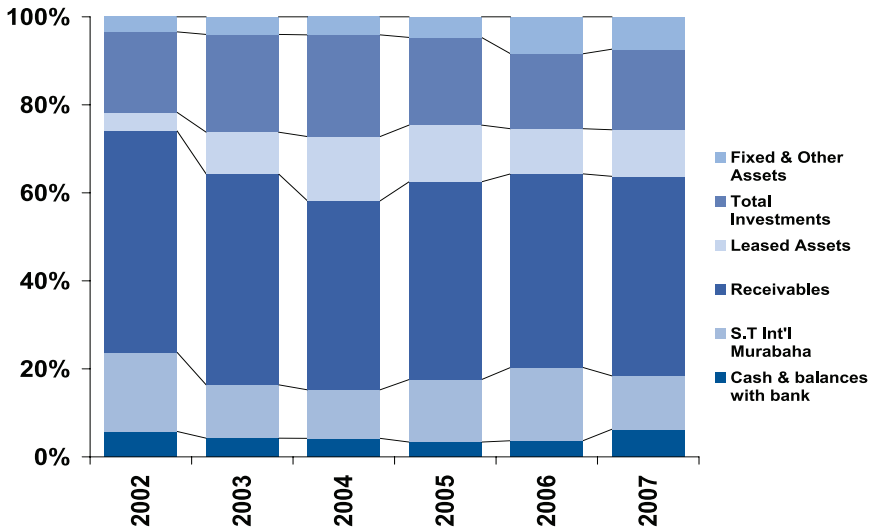
Consequently, KFH investment portfolio were higher by 56% in 2007 compared to 2006 and recorded KD 1.24 billion, of which KD 896.10 million and KD 341.28 million were reported on Available for sale investment and investment in associates respectively. Meanwhile, trading properties reversed last year's decline and rose by 39.74% in 2007 to KD 126.41 million, while on the other hand, investment properties grew by 29.20% to KD 247.3 million compared to 2006.

Investment portfolio grew by 56% and recorded KD 1.24 billion in 2007

KFH's liquid assets which include cash and cash equivalents and short term international Murabaha continued to reflect a double digit growth rate in 2007 to KD 1.62 billion, higher by 26.37% compared to 2006. KFH's liquid asset ratio (liquid assets to total assets) dropped to 18.42% as of end 2007 compared to 20.31% as of end 2006.

Liquid assets continued to show double digit growth

Chart 4. KFH Asset Base Decomposition (2002-2007)



Source: KFH Financial Statements & KAMCO Research

On the funding side and capital base, KFH commands the second largest deposit base among local banks with total deposits amounting to around KD 6.55 billion as of the end 2007, higher by 36% from that of 2006 and contributing to around 20.71% of total listed banks' deposits. This growth in deposits was mainly attributed to the modest increase of 9.9% witnessed in deposits from financial institutions ending the year at KD 1.19 billion coupled with a 43.7% rise in customer deposits which recorded KD 5.36 billion. According to the Central Bank of Kuwait statistical reports, total banks deposits in local and foreign currency witnessed a growth of 21.6% to reach KD 30.3 billion by December 2007.

KFH commands the largest customer deposit base after NBK.

In line with the sharp increase in customer deposits, the ratio of customer deposits to total assets increased in 2007 to reach 60.94% compared to

59.08% in 2006. However the total deposits to total assets ratio declined to 74.42% from 76.18% for the same period. A ratio also worth mentioning is the net loans to total deposits ratio which stood 91.42% as of the end of 2007 compared to 93.07% in 2006.

As of the end of 2007, total shareholders equity stood at close to KD 1.30 billion, up by 67% from that of 2006. During the first quarter of 2007 and following the bank's 15% bonus share announcement and a rights issue, KFH share capital rose to KD 171.54 million and therefore increasing the total equity to assets ratio to 14.8% compared to last year's ratio of 12.3%. Furthermore, equity to net loans ratio followed the same uptrend reaching 21.70% in 2007 compared to 17.4% recorded in 2006.

Shareholders equity jumped by 67% to KD 1.3 billion in 2007.

Table 2. KFH Customer Deposits & Key Capital Structure Ratios

	2002	2003	2004	2005	2006	2007
Customer Deposits *(KD million)*	1,977	2,300	2,563	3,189	3,730	5,361
Growth in Customer Deposits (%)	11.4	16.4	11.4	24.4	16.9	43.7
Total Equity *(KD million)*	267.7	304.4	357.6	673.7	777.8	1,298.8
Growth in Equity (%)	10.3	13.7	17.5	88.4	15.5	67.0
Net Loans/Total Deposits (*%)*	93.1	89.5	88.3	97.1	93.1	91.4
Liquid Assets/ Total Assets (*%)*	23.8	16.4	15.2	17.6	20.3	18.4
Equity to Net Loans (*%)*	14.5	14.4	15.1	20.0	17.4	21.7
Customer Deposits/ Total Assets (*%)*	77.4	75.6	74.1	68.1	59.1	60.9
Equity/ Total Assets *(%)*	10.5	10.0	10.3	14.4	12.3	14.8

Source: KFH Financial Statements & KAMCO Research

Projections

Based on KFH's strategy for expansion and the bank's recent performance, we have updated our projections for KFH for the period between 2008 and 2012. Our future outlook for KFH continues to be positive well supported by the favorable macroeconomic and interest rate environment, liquidity in the economy and the bank's current market position with in the banking industry is outlined in more detail below.

Our confidence in KFH stems from its consistence performance in the past

Total banking industry loans is expected to maintain its historical 8-year average annual growth supported by resilient economic expansion on the back of high oil prices and continued, yet controlled, growth in local liquidity. Given the substantial size of KFH's loan and deposit portfolios in comparison to its peers in the local market with KFH capturing around 31% of total industry loans and 32% of total industry deposits as of the end of 2007, which approximately corresponds to the bank's historical market share over the past six years, we expect that KFH would maintain its share of the industry's loan and deposit portfolio during the forecast period.

KFH commanded 31% and 32% of the industry's loan and deposit portfolios respectively.

The Islamic banking assets have been growing at more than 20% plus in the past few years and we expect the industry to maintain or even better these growth rates given the high demand for Islamic products in the market. Accordingly, we expect KFH's growth in assets to mirror a similar trend. We forecast KFH's total assets to grow by a CAGR of close to 20% over the next five years.

Growth in the Islamic banking assets is expected to rapidly rise.

Following the US Fed's decision to cut the benchmark rates, the Central Bank of Kuwait (CBK) also followed suit and reduced the discount rates by 50 basis points from 6.25% to 5.75% in January 2008. In an attempt to boost the slowing US economy and control inflation, further cuts from the US Fed is envisaged during 2008. Accordingly we expect the CBK also to further lower its discount rate in 2008. We expect lower discount rates in Kuwait to augment higher borrowings and hence the loan portfolio for KFH. As a result we believe the interest earning assets mainly comprising the receivables and leased assets to grow at around 20% CAGR from KD 6.54 billion (2007) to KD 16.14 billion (2012) during the forecast period.

Lower discount rates is expected to spur borrowings.

Loan book forecast to grow at 20%

We expect the net interest income also to mirror a similar trend and grow at a CAGR of around 19% during the forecast period (2008-2012). Net interest income is estimated to grow from KD 259.4 million in (2008) to KD 523.6 million (2012). During the past five years, the net interest margins have averaged around 3% and stood at 3.67% in 2006 and 3.99% in 2007. On a conservative basis, we forecast net interest margins at 3.60% in 2008, 3.65% in 2009 and subsequently drop to 3.5% by the end of the forecast period.

Net interest income to grow at 19% CAGR over the forecast period and net interest margins to reach 3.5% by 2012

Keeping in mind the banks investment portfolio, investment in associates

and other real estate investments, we expect non-interest income to grow at 21% CAGR from KD 457.4 million (2008) to KD 986 million (2012).

Non interest income estimated to increase by 21% CAGR

We forecast net profit to increase by 26% CAGR during the forecast period from KD 325.3 million (2008) to KD 811 million (2012). Subsequent to the 20% stock dividends for 2007 and on the diluted number of shares, EPS is estimated at 158 Fils per share in 2008 and reach 394 Fils per share by 2012.

Net profits estimated to grow by 26% CAGR (2008-2012)

Table 3. KFH Key Projected Revenue & Income Figures

('000 KD)	2008f	2009f	2010f	2011f	2012f
Net Interest Income	**259,401**	**318,059**	**382,436**	**452,071**	**523,612**
Investment Income	342,814	438,594	545,131	655,115	768,453
Fees & Commissions	67,350	80,820	96,984	116,381	139,657
Other Operating Income	47,258	53,539	60,680	68,804	78,049
Non-Interest Income	457,422	572,953	702,796	840,300	986,159
Total Net Operating Income	**716,823**	**891,012**	**1,085,232**	**1,292,371**	**1,509,771**
Total Operating Expenses	324,174	385,300	457,911	514,537	588,129
Net Profit	**325,320**	**429,105**	**540,604**	**679,410**	**811,103**
EPS (KD)	0.158	0.208	0.263	0.330	0.394

Source: KAMCO Research

Valuation

We updated the valuation of KFH's fair value per share on the basis of three valuation methodologies. The Discount Cash flow method using the estimated intrinsic value of KFH stock from the viewpoint of strategic/long-term investors, and the relative or comparable valuation methods using P/E and P/B ratios for the banking sector in Kuwait.

Discounted Cash Flow Valuation Model (DCF)

The DCF model calculates the free cash flow available to equity holders (FCFE) by adjusting the forecasted net income figures for non-cash expenses and expected capital expenditures.

After calculating KFH free cash flow to equity, a perpetual growth rate was estimated to arrive at the bank's terminal value. Finally, the FCFE figures in addition to the terminal value were discounted at the calculated cost of equity, which were then summed together to arrive at the DCF value of KFH equity. The DCF method resulted in a fair value per share of KD 3.856.

We value KFH at KD 3.856 per share based on the DCF model...

Table 4. DCF Valuation Assumptions

Perpetual Growth Rate					**7.00%**
KFH Beta*					1.23
Risk Free Rate^					6.625%
Equity Risk Premium#					5.81%
Cost of Equity##					**13.79%**
('000 KD)	**2008f**	**2009f**	**2010f**	**2011f**	**2012f**
Net Profit	**325,320**	**429,105**	**540,604**	**679,410**	**811,103**
Add: Depreciation	37,899	46,480	56,751	66,739	77,850
CAPEX	(43,313)	(59,760)	(81,072)	(95,342)	(166,820)
FCFE	**319,906**	**415,825**	**516,283**	**650,808**	**722,132**
Terminal Value					**11,381,819**
PV of FCFE*	**290,367**	**331,693**	**361,922**	**400,941**	**390,971**
Total PV of FCFE	**1,775,895**				
PV of Terminal Value	**6,162,263**				
Total Equity Value	**7,938,158**				
Shares Outstanding('000)	**2,058,409**				
Fair Share Value (KD)	**3.856**				

** Based on trailing 3-year daily returns ^ Average yield on long-term treasury bonds*
 # Aswath Damodaran interpretation of Kuwait's Equity Risk Premium
Calculated using the Capita Asset Pricing Model
** Discounted as of the end of March 2008*
Source: KAMCO Research

Table 5. presents a sensitivity analysis on KFH DCF value per share based on changes in the underlying cost of equity and the assumed terminal growth rate.

Table 5. Sensitivity Analysis of KFH DCF Value Per Share

Perpetual Growth Rate	Cost of Equity						
	13.00%	**13.25%**	**13.50%**	**13.79%**	**14.00%**	**14.25%**	**14.50%**
4.00%	3.149	3.059	2.974	2.881	2.816	2.743	2.674
4.50%	3.294	3.195	3.101	3.000	2.929	2.850	2.774
5.00%	3.457	3.347	3.244	3.132	3.055	2.968	2.885
5.50%	3.642	3.519	3.404	3.280	3.195	3.099	3.009
6.00%	3.853	3.715	3.586	3.448	3.353	3.247	3.147
6.50%	4.097	3.940	3.794	3.638	3.532	3.413	3.302
7.00%	4.381	4.201	4.034	**3.856**	3.736	3.603	3.478
7.25%	4.542	4.347	4.168	3.978	3.850	3.707	3.575
7.50%	4.718	4.507	4.314	4.110	3.972	3.820	3.679
8.00%	5.121	4.871	4.644	4.406	4.247	4.072	3.911
8.50%	5.614	5.312	5.041	4.759	4.572	4.369	4.182
9.00%	6.230	5.857	5.526	5.186	4.962	4.721	4.502
9.50%	7.022	6.547	6.132	5.712	5.439	5.148	4.886

Source: KAMCO Research

Relative Valuation

Following the Relative Valuation approach, we used the average Price to Earnings and Price to Book for the local banking sector based on year-to-date (YTD) weighted average daily market cap and full year 2007 earning and equity figures. The sector's P/E and P/B multiples were calculated to be 18.42x and 3.64x respectively.

Based on KFH expected earnings per share and book value per share for 2008 of KD 0.158 and KD 0.735 respectively and capitalizing these per share figures to the local banking industry's average P/E and P/B multiples, resulted in KFH's fair value per share at KD 2.911 and KD 2.677 respectively.

...and KD 2.911 and KD 2.677 per share based on the P/E and P/B methods.

Valuation Conclusion

We used a weighted average of the above valuation models, assigning a 70% weight to the DCF - FCFE method, and 15% each to the P/E and P/B methods to arrive at an estimated fair value of ***KD 3.538*** per share. KFH is currently trading at 19.16% discount to our fair value estimate indicating a ***Strong Buy*** following KAMCO's recommendation scale.

We estimate the weighted fair value of KFH at 3.538 per share and recommend a strong buy.

Table 6. KFH Weighted Average Value per Share

Method	Weight (%)	Value per Share (KD)
Discounted Cash Flow	70	3.856
Sector's P/E	15	2.911
Sector's P/B	15	2.677
KFH Weighted Avg. Value per Share		**3.538**

Source: KAMCO Research

Trading & Share Data

Table 7. Historical Share Data

	2003	2004	2005	2006	2007	YTD-08*
Market Capitalization ('000 KD)	1,147,018	1,281,506	2,603,649	2,671,032	4,940,182	5,887,053
Closing Share Price (KD)	1.600	1.640	2.380	2.180	2.880	2.860
High (KD)	1.600	1.780	2.600	2.640	3.080	4.00
Low (KD)	1.040	1.200	1.340	1.800	1.880	2.860
Volume ('000 Shares)	234,815	169,585	267,136	188,110	499,344	159,335
Value (KD thousand)	301,479	256,216	500,664	403,091	1,276,983	530,688
Number of Deals	8,602	9,628	16,943	14,892	33,398	11,343
EPS (KD)	0.077	0.087	0.122	0.102	0.166	0.166
Book Value Per Share (KD)	0.397	0.418	0.560	0.574	0.705	0.705
Dividend Per Share (KD)	0.050	0.050	0.055	0.057	0.065	0.065
Price to Earnings Multiple (X)	37.33	33.00	23.51	27.92	17.21	21.39
Price to Book Value Multiple (X)	7.20	6.85	5.11	4.99	4.05	4.53
Dividend Yield (%)	1.75	1.75	1.92	1.99	2.27	2.27
Pay-out Ratio (%)	65.26	57.70	45.21	55.65	39.11	NA

NA: Not Applicable

**: As of 31 March 2008*

#: Based on the closing price as of 31 March 2008 and FY 07 EPS, equity figures as of Dec 07 and dividends for FY 07

Source: KAMCO Research

Ratio Analysis

Ratio Analysis	2002	2003	2004	2005	2006	2007
Growth						
Net Interest Income	(16.6%)	(1.0%)	31.7%	19.6%	103.9%	48.4%
Non Interest Income	52.7%	33.1%	24.3%	175.7%	30.0%	44.9%
Total Operating Income	6.1%	15.1%	27.6%	102.5%	50.5%	46.2%
Net Profit	6.4%	6.5%	27.9%	59.5%	36.5%	69.9%
Interest Earning Assets	6.1%	12.2%	12.2%	40.2%	33.4%	38.9%
Total Assets	7.5%	19.1%	13.7%	35.4%	34.9%	39.3%
Shareholders Equity	10.3%	13.7%	17.5%	88.4%	15.5%	67.0%
Asset Structure Ratios						
Average Interest Earning Assets / Total Assets	76.0%	69.8%	68.8%	64.6%	65.2%	63.9%
Total Deposits/ Total Assets	77.9%	77.7%	77.6%	74.1%	76.2%	74.4%
Customer Deposits/ Total Assets	77.4%	75.6%	74.1%	68.1%	59.1%	60.9%
Net Loans/ Total Assets	72.5%	69.5%	68.6%	72.0%	70.9%	68.0%
Investment Assets / Total Assets	18.3%	22.2%	23.1%	19.9%	17.0%	18.3%
Shareholders Equity / Total Assets	10.5%	10.0%	10.3%	14.4%	12.3%	14.8%
Equity to Net Loans	14.5%	14.4%	15.1%	20.0%	17.4%	21.7%
Asset Quality Ratios						
Loan-Loss Reserves/ Gross Loans	5.4%	4.9%	4.9%	4.5%	3.8%	2.7%
Loan-Loss Provison/ Gross Loans	0.13%	0.18%	0.54%	1.04%	0.58%	0.62%
Non-Performing loans /Gross loans	NA	4.44%	3.91%	2.79%	2.56%	1.76%
Loan-Loss Provision/ Non-Performing loans	NA	4.1%	13.9%	37.4%	22.6%	35.0%
Liquidity Ratios						
Net Loans / Customer Deposits	93.7%	91.9%	92.5%	105.7%	120.0%	111.7%
Net Loans / Total Deposits	93.1%	89.5%	88.3%	97.1%	93.1%	91.4%
Customer Deposits/ Total Deposits	99.4%	97.3%	95.5%	91.9%	77.5%	81.9%
Liquid Assets/ Customer Deposits	30.7%	21.7%	20.6%	25.8%	34.4%	30.2%
Liquid Assets/ Total Deposits	30.5%	21.1%	19.6%	23.7%	26.7%	24.8%
Liquid Assets Ratio	23.8%	16.4%	15.2%	17.6%	20.3%	18.4%
Profitability Ratios						
Return on Assets (ROA)	2.14%	1.91%	2.15%	2.54%	2.57%	3.13%
Return on Equity (ROE)	20.85%	20.44%	22.83%	19.77%	23.06%	22.75%
Return on Average Assets (ROAA)	2.22%	2.08%	2.29%	2.92%	2.95%	3.64%
Return on Average Equity (ROAE)	20.85%	21.28%	24.38%	25.63%	24.87%	28.79%

Ratio Analysis	2002	2003	2004	2005	2006	2007
Margin Analysis						
Interest Income/ Avg Earning Assets	5.36%	5.04%	5.61%	6.51%	7.95%	8.30%
Funding Cost	2.94%	2.75%	2.83%	3.98%	4.26%	4.27%
Interest Differential	2.42%	2.29%	2.77%	2.52%	3.69%	4.03%
Net Interest Margin	2.45%	2.22%	2.60%	2.45%	3.67%	3.99%
Distribution to Depositors/ Avg. Cust.Deposits	3.02%	2.80%	2.94%	4.26%	5.10%	5.34%
Contribution Analysis						
Net Interest Income / Operating Income	52.9%	45.5%	46.9%	27.7%	37.5%	38.1%
Non Interest Income / Operating Income	47.1%	54.5%	53.1%	72.3%	62.5%	61.9%
Cost To Income Ratio	32.5%	35.5%	29.5%	36.4%	43.9%	36.6%

NA: Not Available
Source: KFH Financial Statements & KAMCO Research

Financial Statements

Balance Sheet	2002	2003	2004	2005	2006	2007
('000 KD)						
Assets						
Cash With Banks & Other F.I	147,882	129,208	146,161	158,293	231,996	553,565
Short-Term Int'l Murabaha	458,916	369,369	380,646	663,848	1,050,599	1,067,291
Net Receivables	1,285,361	1,457,494	1,484,971	2,104,346	2,778,166	3,988,131
Leased Assets	107,662	287,990	505,550	603,333	647,939	930,657
Investments	250,763	433,410	565,038	698,013	793,889	1,237,377
Trading Properties	112,098	139,615	127,835	93,009	90,463	126,413
Investment Properties	104,684	102,447	105,921	140,892	191,407	247,300
Property & equipment	24,847	58,556	72,208	151,282	401,005	407,488
Other assets	62,164	63,021	69,736	68,102	128,327	239,694
Total Assets	**2,554,377**	**3,041,110**	**3,458,066**	**4,681,118**	**6,313,791**	**8,797,916**
Liabilities						
Due To Banks & F.I.	12,640	63,676	121,821	281,617	1,080,004	1,186,391
Customers' Deposits	1,976,861	2,300,161	2,563,185	3,189,344	3,729,930	5,361,155
Other Liabilities	102,572	169,864	204,807	220,795	289,325	380,853
Total Liabilities	**2,092,073**	**2,533,701**	**2,889,813**	**3,691,756**	**5,099,259**	**6,928,399**
Deferred Revenue	**175,724**	**182,410**	**189,002**	**235,239**	**299,263**	**374,608**
Fair Value Reserve	**5,771**	**19,776**	**31,680**	**62,092**	**66,654**	**86,843**
FX Translation Reserve	**-**	**-**	**-**	**11,401**	**8,683**	**1,972**
Minority Interest	**18,840**	**20,637**	**21,633**	**80,420**	**137,443**	**196,094**
Share Capital	68,275	71,689	78,141	109,397	122,525	171,535
Share Premium	7,708	7,826	12,618	188,465	188,788	464,735
Treasury Shares	(902)	(867)	(1,016)	(1,278)	(304)	1,006
Proposed Cash Dividends	32,089	35,844	39,070	60,168	69,839	111,498
Proposed Issue of Bonus Shares	3,414	4,301	7,814	13,128	18,379	34,307
Statutory & Voluntary Reserves	151,385	165,793	189,311	230,330	299,025	422,682
Total Equity	**267,740**	**304,362**	**357,618**	**673,703**	**777,826**	**1,298,815**
Liabilities, Equity, & Others	**2,554,377**	**3,041,110**	**3,458,066**	**4,681,118**	**6,313,791**	**8,797,916**

Source: KFH Financial Statements & KAMCO Research

Income Statement	2005	2006	2007	2008f	2009f	2010f	2011f	2012f
('000 KD)								
Net Interest Income	**74,148**	**151,161**	**224,365**	**259,401**	**318,059**	**382,436**	**452,071**	**523,612**
Investment income	140,453	183,249	266,397	342,814	438,594	545,131	655,115	768,453
Fees & commissions	33,363	44,008	56,125	67,350	80,820	96,984	116,381	139,657
Net gain/(loss) from FX	6,214	3,332	14,696	16,166	17,782	19,560	21,516	23,668
Other operating income	13,351	20,875	27,037	31,093	35,756	41,120	47,288	54,381
Total Net Operating Income	**267,529**	**402,625**	**588,620**	**716,823**	**891,012**	**1,085,232**	**1,292,371**	**1,509,771**
General & administrative	75,095	111,132	121,917	173,251	212,482	259,432	305,094	355,884
Depreciation	15,528	33,754	27,939	37,899	46,480	56,751	66,739	77,850
Murabaha & Ijara costs	6,792	32,041	65,712	68,998	72,447	76,070	79,873	83,867
Total Operating Expenses	**97,415**	**176,927**	**215,568**	**280,148**	**331,409**	**392,252**	**451,707**	**517,600**
Pre-Provision Income	**170,114**	**225,698**	**373,052**	**436,675**	**559,603**	**692,980**	**840,664**	**992,171**
Provision for impairment	37,047	27,180	38,179	44,026	53,891	65,659	62,830	70,529
Profits Before Min. Interest	**133,067**	**198,518**	**334,873**	**392,649**	**505,712**	**627,321**	**777,834**	**921,642**
Minority interest	10,391	31,226	50,129	55,142	60,656	66,722	73,394	80,733
Profits Before Taxes & BOD	**122,676**	**167,292**	**284,744**	**337,507**	**445,056**	**560,599**	**704,440**	**840,908**
KFAS	1,227	1,673	2,847	3,375	4,451	5,606	7,044	8,409
Board remuneration	150	150	200	200	200	200	200	200
National labor support tax	2,612	3,465	6,257	8,438	11,126	14,015	17,611	21,023
Zakat	-	-	174	174	174	174	174	174
Net profit for the year	**118,687**	**162,004**	**275,266**	**325,320**	**429,105**	**540,604**	**679,410**	**811,103**
EPS (KD)	***0.107***	***0.102***	***0.166***	***0.158***	***0.208***	***0.263***	***0.330***	***0.394***

f: KAMCO Forecast
Source: KFH Financial Statements & KAMCO Research

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