Kuwait

Investment Update

Kuwait Finance House

Tickers:
KFIN.KW (Reuters)
KFIN KK (Bloomberg)

Listing:
Kuwait Stock Exchange

Fair Value:
KD1.04

CMP:
KD1.36 (as on June 10, 2009)

June, 2009

Sell

Investment Summary

- **Kuwait Finance House (KFH)** is the largest bank in Kuwait by virtue of its deposits base and the second largest on account of assets, loans and profitability. It is not only a well-recognized brand associated with Islamic finance within the GCC region but also has a presence in Turkey, Singapore and Malaysia.

- KFH staged a decline of 43%YoY in its profits in 2008. The bank's bottom-line was overwhelmingly dictated by the sudden and enormous rise in NPLs which lead to huge provisions being set aside, leading naturally to diminished earnings. Other smaller factors affecting the bottom-line adversely include high provisions against investments and lower income from investments.

- The bank's profitability was adversely impacted by an immense rise in NPLs which led to heavy provisioning. With an investments base (equity and mutual funds) of approximately KD800mn (estimated 7.6% of total assets), the bank is a player in the equity markets and therefore was one of the roughly hit ones in the decline in the stock markets in 4Q08.

- We understand that the main challenge that the bank will face over the forecast period will be regarding maintenance of asset quality, which according to our forecast may take another small dip before eventual recovery.

- We believe that going forward, KFH's balance sheet growth will remain in check with marginal growth expected for 2009. Balance sheet expansion is expected to pick up in the years following, depending on the revival in the economy and the level of business confidence. We have nevertheless remained conservative in our estimates regarding the growth in the balance sheet.

- KFH's top-line is anticipated to exhibit a slower but very healthy and sustainable growth owing to slower growth in earning assets and spreads that are expected to remain between 4.9% and 5.1% over the forecast period. The contribution of volumes, on the whole, would be the key driving factor behind the net commission income with spreads, which we believe have already seen the peak, to come down to weigh upon the growth in the net commission income. Subsequent to a muted movement in 2009, net commission income growth is anticipated to be healthy, exhibiting a 2008 – 2012 CAGR of 9%.

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- KFH's earnings have historically shown dependence over investment income which is by nature not as recurring as core income. Albeit, investment income has been a big part of the bank's earnings, we feel more comfortable in reducing it to the levels of 20 – 25% in our forecasts. A healthy growth in investment income in the range if 20 – 25%YoY may therefore ensue leading to a similar growth in the total non-commission income.

- We expect the bottom-line to exhibit a profitability decline of 20%YoY in 2009 owing to higher provisions, lower non-commission income and stagnancy in the top-line. High growth in the earnings is then expected to ensue, driven by improving net commission income, higher investment income pushing growth in the non-commission income, and a decline in the provision requirements as asset quality improves and the need to provide coverage declines. The bank is therefore anticipated to exhibit earnings CAGR of 20% over the forecast period.

- Based on the current market price of KD1.36/share (June 10, 2009), KFH is trading at 2009E P/E and P/BV multiple of 25.0x and 2.7x respectively. Our estimated value for this banking scrip is worked out to be KD1.04 based on DDM (80%) and adaptation of the Gordon Growth Model (20%). According to our fair value the banking scrip offers a downside of 23.7% over the closing price. We therefore downgrade our recommendation on the scrip from HOLD to **SELL**.

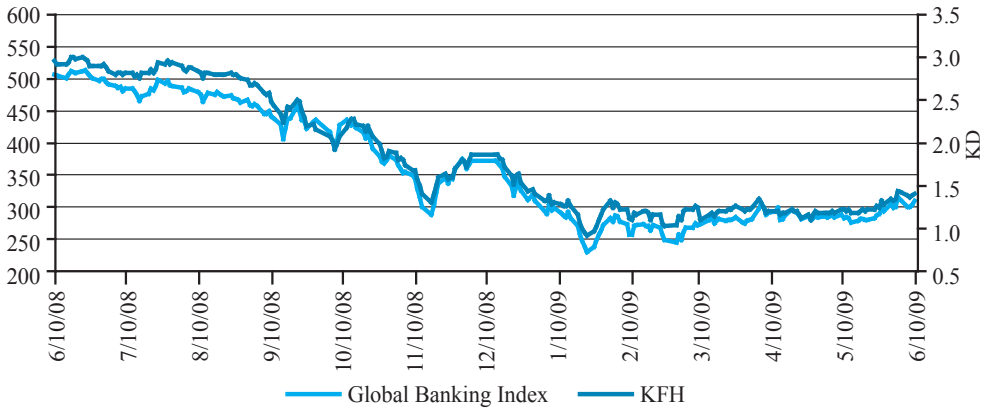
Table 01: Investment Indicators

Price (June 10, 2009) KD	Shares in issue (mn)	Market Cap - KD mn	52 - week price range (KD)
1.36	2,305.4	3,135.4	0.79 - 2.64

Year	Operating Income (KD mn)	Net Profit (KD mn)	EPS (fils)	BVPS (fils)	ROAA (%)	ROAE (%)	P/E (x)	P/BV (x)
2010F	577.6	194.6	84.4	518.2	1.7%	16.5%	16.1	2.6
2009F	486.9	125.6	54.5	505.5	1.2%	10.8%	25.0	2.7
2008A	427.7	157.0	68.1	502.4	1.6%	13.9%	23.1	3.1
2007A	400.5	275.3	119.4	476.5	3.6%	31.8%	17.9	4.5

Historical P/E & P/BV multiples pertain to respective year -end prices, while those for future years are based on closing prices as of June 10, 2009
*Source: Zawya, **Global** Research*

Figure 01: Share Price Performance Chart

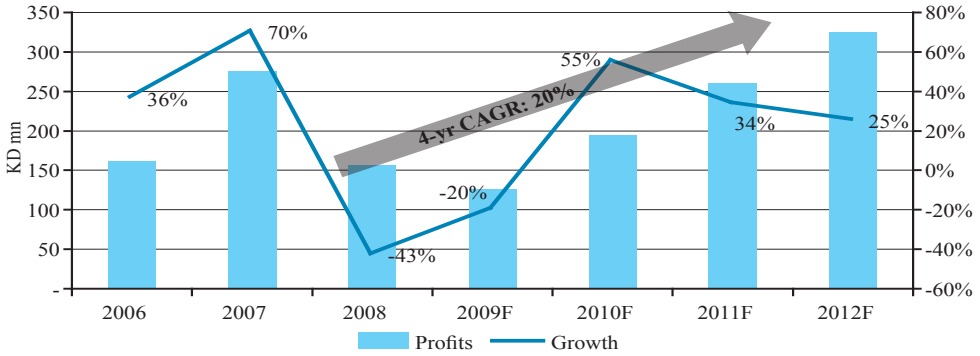


*Source: **Global** Research*

Profit growth to see a further decline...

KFH staged a decline of 43%YoY in its profits in 2008. The bank's bottom-line was overwhelmingly dictated by the sudden and enormous rise in NPLs which lead to huge provisions being set aside, leading naturally to diminished earnings. Other smaller factors affecting the bottom-line adversely include high provisions against investments and lower income from investments. The bank did end up with positive earnings, owing to the good performance of the KFH's top-line (net commission income) which swayed upwards by 54%YoY in 2008.

Figure 02: Profitability trends



Source: Company Accounts, ***Global*** *Research*

We believe that the decline in profitability is not over and another slide in the earnings is on the cards, which is expected to materialize in 2009 as per our forecast. The decline is anticipated to be driven by high provisions, stagnancy in the top-line and a further decline in non-fund income. The confluence of these factors is expected to result in a 20%YoY erosion in the profits of the bank in 2009. We further believe that KFH will exhibit a strong earnings growth then onwards, with an earnings CAGR of 20.0% for the 2008 – 2012 period. This surge in the profits will be highlighted by a healthy growth in the net commission income (NCI), higher non-fund income generation and relatively lower provisioning requirements.

Net Commission Income growth trajectory to diminish considerably but remain healthy

KFH has exhibited a very strong growth in its net commission income over the past, evident from a 4-yr CAGR of 54% till 2008. The year under review was no different, and witnessed a 54%YoY jump in the net commission income. The rise in the net commission income in 2008 was on account of both, a large growth in the earning assets and a favourable change in spreads. The bank's net receivables and leased assets cumulatively grew a healthy 21%YoY in 2008 while its total earning assets grew 22%YoY to stand at KD6.0bn and KD7.3bn respectively. This was driven by a 25%YoY growth in commission bearing liabilities which were reported at KD8.2bn at the end of 2008. The bank's spreads improved significantly on account of the declining cost of funds out-pacing the fall in lending yield, having a very positive impact on the KFH's top-line.

Table 02: Volume - Spread Analysis

'000 KD	**2007**	**2008**
Change in lending yield	0.58%	-0.46%
Impact	**22,698**	**(24,018)**
Change in avg. comm. earning assets	1,307,276	1,398,531
Impact	**116,672**	**118,396**
Change in cost of funds	0.01%	-1.33%
Impact	**(469)**	**75,644**
Change in avg. comm. bearing liabilities	1,538,293	1,698,537
Impact	**(65,697)**	**(49,916)**
Total impact on NCI	**73,204**	**120,106**
Volume impact	50,975	68,480
Spreads impact	22,229	51,626

Source: ***Global*** *Research*

The following points can be derived from the table above, for 2008:

1. The yield on financings and the cost of funds both declined.

2. The fall in the cost of funds outpaced the fall in yields on financings leading to an 87bps improvement in the spreads.

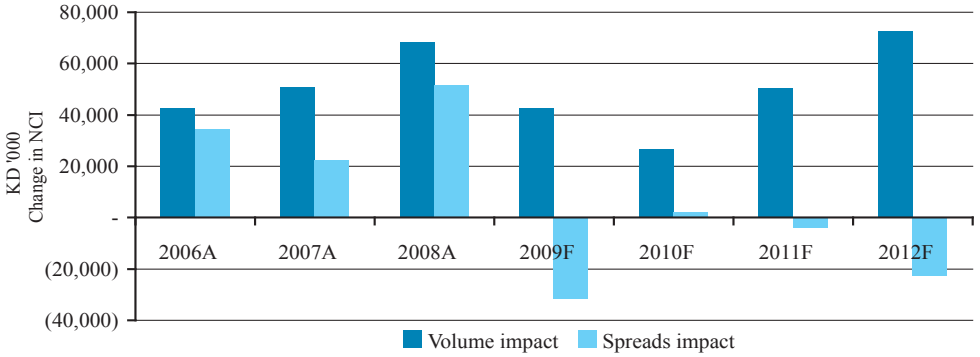
3. The increase in average earning assets and the decline in the cost of funds positively impacted the net commission income. The positive impact emanating from average earning assets was more than the same coming from the tapering-off cost of funds.

4. The increase in average cost bearing liabilities had a higher negative impact on the net commission income than the fall in the yield on earning assets.

5. Both volumes and spreads worked in unison to augment the net commission income. The impact of volumes and spreads was higher than that in 2007.

The analysis above explains what happened in 2008, and the chart shows that the impacting factors have behaved in a very similar fashion since 2006. Going forward, however, we believe that the factors will act differently, breaking the 3-year trend that had started in 2006. The impact of spreads is expected to be unfavourable towards the net commission income in 2009 which is then anticipated to turn positive in the year following. The contribution of volumes, on the whole, would be the key driving factor behind the net commission income with spreads, which we believe have already seen the peak, to come down to weigh upon the growth in the net commission income. Subsequent to a muted movement in 2009, net commission income growth is anticipated to be healthy, exhibiting a 2008 – 2012 CAGR of 9%.

Figure 03: Impact of spreads and volumes on the Incremental NCI

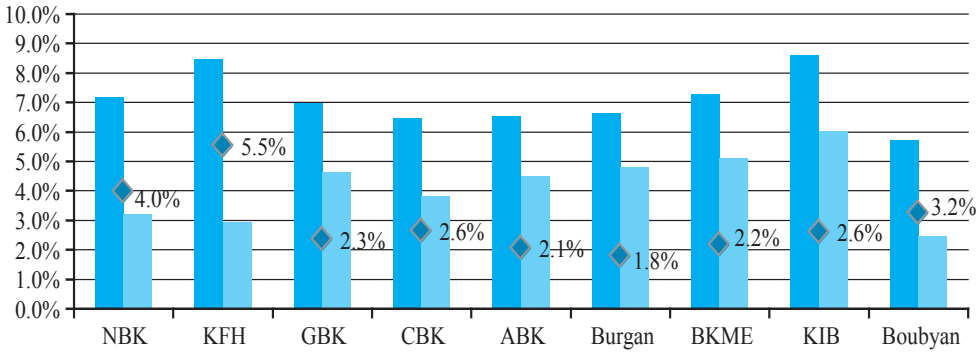


*Source: **Global** Research*

Maintaining the highest spreads in Kuwait

KFH has very strong brand equity in Kuwait and the region given its extensive branch network in Kuwait and the region along with its geographical reach. KFH became the biggest bank in terms of deposits in 2008 and stands second only to NBK in terms of assets and loans. That combined with the Sharia'h compliant nature of its operations, has helped KFH maintain the highest spreads amongst Kuwaiti banks through a combination of high yields on assets and comparatively lower cost of funds.

Figure 04: Yields and spreads - 2008



*Source: **Global** Research*

KFH exhibited a sizeable jump in its spreads in 2008, following a unidirectional upward movement since 2006. Given the intrinsic nature of deposits in an Islamic bank, KFH ended with one of the lowest cost of funds amongst Kuwaiti banks. The cost of funds for 2008, which stood at 2.9%, was the lowest for the bank since 2004.

Table 03: Change in deposits rates by type

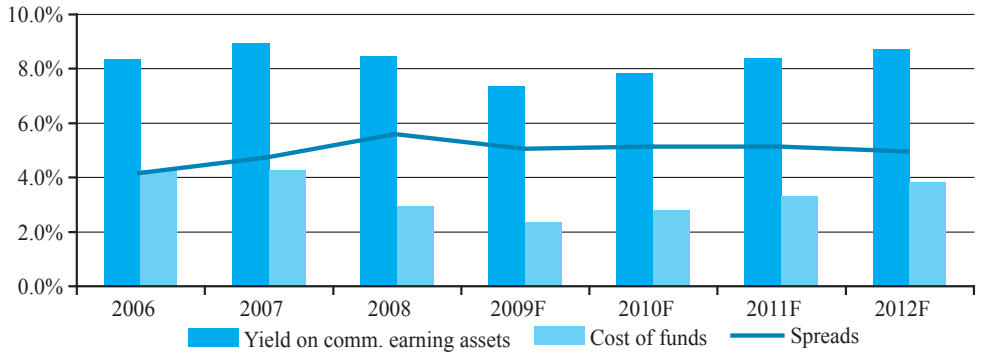
	2007	2008	Δ rates
Investment deposits - Mustamera	8.63%	4.30%	-4.33%
Investment deposits - Sedra	6.71%	3.34%	-3.37%
Investment savings accounts - Tawfeer	5.76%	2.87%	-2.89%

Source: Company Reports

We believe that the yield on earning assets and the cost of funds of KFH will come down further, with the former reducing more than the latter, since the cost of funds, which is already

4-year lowest, has limited room towards contraction. The ramifications of such a happening will be visible in a squeeze in the spreads, which are expected to fall by approximately 50bps to 5.0% in 2009. Spreads then onwards, are anticipated to remain relatively unchanged when an increasing interest rates scenario sets in. We forecast KFH to remain range-bound between 4.9% and 5.1% for the 2009 – 2012 period.

Figure 05: Spreads

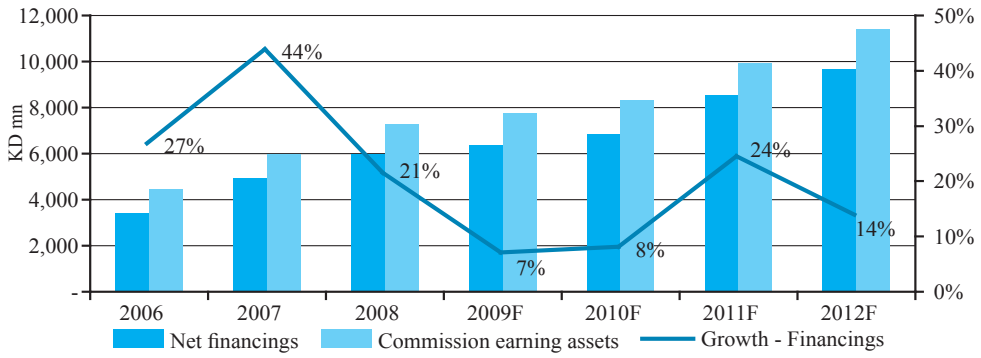


*Source: Annual reports, **Global** Research*

Loans disbursement expected to slow-down!

Commission earning assets of KFH, which had exhibited a huge CAGR of 32% for the 2004 – 2008 period, had continued to exhibit a sizeable rise in 2008 with a 22%YoY growth. Aggregate receivables and leased assets grew 24%YoY in 2008 portraying the bank's aggressive loans disbursement drive.

Figure 06: Financings growth trends



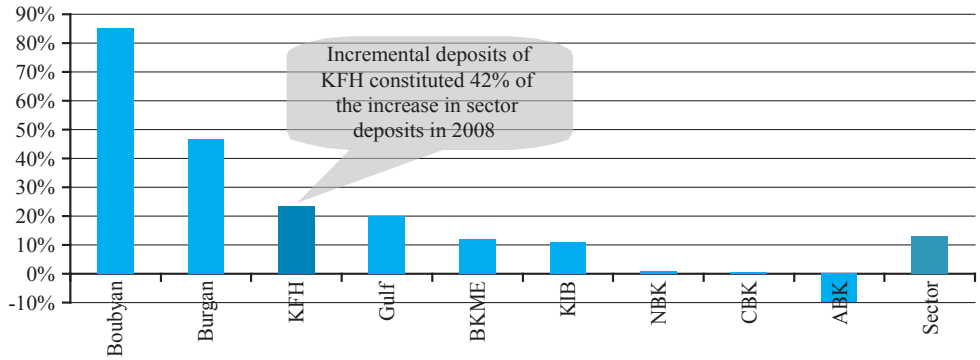
*Source: Annual reports, **Global** Research*

The prevalent economic condition in Kuwait and the rest of the GCC has had far-reaching effects on the banks with KFH being no different. Projects and entities to which the associated risk to lend was within the banks' appetite have now become too risky given the returns. As a matter of prudence, a heightened perception of risk and less availability of good opportunities to lend to, we believe that KFH's financings growth will be hit. Beyond 2010, KFH is expected to exhibit a growth in its financings as the economic conditions improve and good lending opportunities come forward. As a result, KFH is anticipated to exhibit financings CAGR of 13.8% over the forecast period.

Deposits growth to be set to early double digits

KFH reported a robust growth in its deposit base in 2008, exhibited by a 23%YoY rise. This was in continuation to a similar growth pattern that the deposits of the bank have undergone in the last few years; apparent from a 2004 – 2008 CAGR of 27%. While the growth in deposits exhibited by banks comparable to KFH, by size, remained either stagnant or very low, KFH clearly out-paced the sector in this respect to the extent that 42% of the incremental deposits in 2008 were collated by KFH alone.

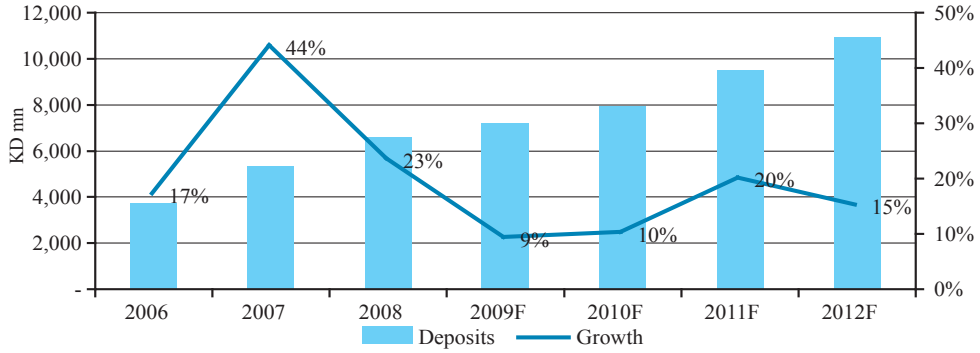
Figure 07: Deposits growth comparison - 2008



Source: Annual reports, ***Global*** *Research*

In the near future we expect KFH to match its deposits mobilization to available lending opportunities, which are expected to remain on the lower side over the first 2 years of the forecast period. We believe that the bank will be strictly opportunistic in its endeavours to disburse loans given a severe decline in credit quality and as a result the increase in deposits needed to fuel that growth will be considerably less. Deposit growth by KFH is anticipated to be limited to 9 – 10% till 2010 and is then expected to pick up, portraying a 2008 – 2012 CAGR of 13%.

Figure 08: Deposits growth



Source: Annual reports, ***Global*** *Research*

Loans quality witnessed serious deterioration, NPLs coverage drops significantly

The loans (not including leased assets) quality of KFH saw drastic worsening as non-performing loans (NPLs) expanded, in an unprecedented move by 312%YoY from KD156mn to KD642mn in 2008. The NPLs to gross loans ratio, a measure of loans quality, as a result rose from just 3.8% in 2007 to 12.6% in 2008, which is the highest amongst Kuwaiti banks. As of end of 2008, KFH accounted for 23% of the gross loans of the listed banking sector and

40% of the NPLs of the same. While provisions expensed during the year were considerably high, the magnitude was still comparatively low to the rise in NPLs, as a consequence, the coverage ratio of the NPLs decreased sharply from a very comfortable 97.0% in 2007 to a perturbing 46.6% in 2008.

KFH's leased assets which form approximately 11% of total assets, also felt a strong pinch with non-performing assets under this category growing by a gargantuan 125%YoY to stand at KD84.7mn. As a result NPLs to net loans ratio increased dramatically from 4.0% in 2007 to 7.0% in 2008.

Figure 09: Loans - Market share 2008

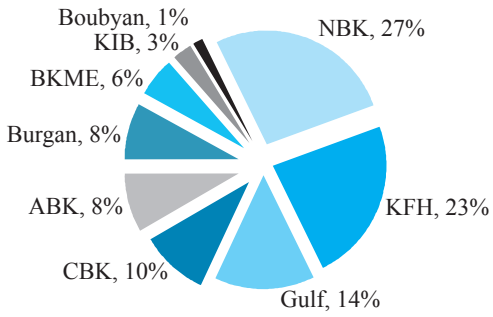
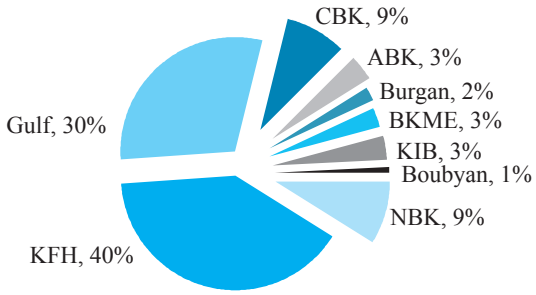


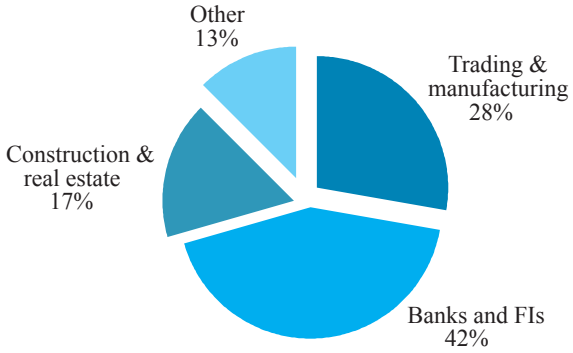
Figure 10: NPLs by bank



With the absence of details hindering us from commenting with surety on where these NPLs originated from, looking at local economic and financial scene leads us to believe that it could have been the financial institutions or the construction & real estate or the loans against shares segment.

KFH has a very high exposure of over 40% of its loans books in banks and financial institutions (FIs), while FIs have been the major problematic sector. Since investment companies have undergone severe battering in 2008 and are still under pressure, KFH's exposure to this economic sector raises worries about the quality of its loans. Moreover, KFH being a prominent player in the construction and real estate market also has loans exposure of around 17% to this segment, as per its financial statements. We however believe that KFH's exposure to this segment may be higher. Our understanding is based on the fact that the aggregate exposure of the Kuwaiti banking sector to the construction and real estate sectors was 31.5% as of 2008 and given KFH's size, a quoted exposure of 17.0% does not add up. A similar understanding goes for loans given for purchase of shares which, according to the Central Bank data, form 11.8% of the total loan. KFH however, does not disclose details regarding this segment and we believe that it might form a part of the 'others' segment.

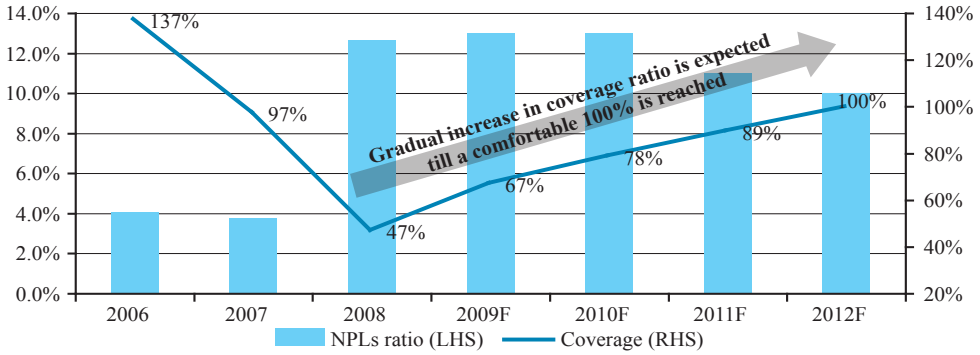
Figure 11: Loans Classification - 2008



*Source: Annual reports, **Global** Research*

We forecast the bank's NPLs ratio to inch slightly upwards to 13.0% in 2009 and to stay there till 2011, when some improvement may be witnessed. Provisions are nevertheless expected to remain high owing to our assumptions regarding step-wise increase in the coverage ratio to 100%, which we believe is necessary in order to maintain proper back-up in case of eventualities.

Figure 12: Asset quality



*Source: Annual reports, **Global** Research*

Capital Adequacy – So far so good…

The Capital Adequacy Ratio of the bank declined slightly from 23% in 2007 to 22% in 2008 due to a decline in Tier 2 capital, which reduced the total capital base to figures below that reported in 2007 while the risk weighted assets grew around 22.7%YoY. The CAR is still much above the regulatory requirement of 12% as stipulated by the Central Bank with the current regulatory capital being a significant 81% higher than what would be required to breakeven.

Financial Performance – 1Q09

- KFH reported a net profit of KD39.3mn for 1Q09 depicting a 46%YoY decline in profitability. While the net commission income (NCI) exhibited a very robust growth, the bottom-line was bogged down by a decline in non-commission income exacerbated by very heavy provisioning.

Table 04: Earnings Snapshot

'000 KD	1Q09	1Q08	YoY
Financing income	131,952	133,092	-1%
Distribution to depositors	(61,410)	(75,245)	-18%
Net Commission Income	**70,542**	**57,847**	**22%**
Fees & Commission Income	16,494	16,765	-2%
Investment income	44,737	66,592	-33%
Other Income	12,752	5,647	126%
Non Commission Income	**73,983**	**89,004**	**-17%**
Operating Expenses	(56,531)	(64,546)	-12%
Provisions	(45,932)	(4,005)	1047%
Operating Profit	**42,062**	**78,300**	**-46%**
Taxation	(2,258)	(2,671)	-15%
Minority Interest	510	2,219	-77%
Net Profit attributable to the parent	**39,294**	**73,410**	**-46%**

Source: Company Accounts

- The bank's estimated distribution to depositors saw a further slide as reported in the quarter, hinting at a further decline in the estimated cost of funds of the bank since deposits increased 1.7%QoQ.

- KFH's other income grew drastically on a YoY basis adding KD13mn to the bottom-line. While details of this increase are not available, we believe that this growth is non-recurring in nature and only approximately KD4 – 5mn of it may recur on a continuous basis.

- Non-commission income declined by 17%YoY purely on account of stagnancy in most sub-heads while investment income, which is the major contributor to this income stream, declined by a huge 33%YoY. Albeit, investment income was lower than that witnessed in the same period in the previous year, it was still high in magnitude, pointing at the bank's ability to generate investment income in troubled times.

- The bank's provisions remained very high, as per expectations, but due to limited disclosures it is difficult to say whether these were in response to a further rise in NPLs or the bank is trying to increase its coverage ratio.

Outlook

KFH is the largest bank in Kuwait by virtue of its deposits base and the second largest on account of assets, loans and profitability. It is not only a well-recognized brand associated with Islamic finance within the GCC region but also has a presence in Turkey, Singapore and Malaysia.

KFH was also hit in the financial turmoil that began in 2008. Its profitability was adversely impacted by an immense rise in NPLs which led to heavy provisioning. With an investments base (equity and mutual funds) of approximately KD800mn (estimated 7.6% of total assets), the bank is a player in the equity markets and therefore was one of the roughly hit ones in the decline in the stock markets in 4Q08. We understand that the main challenge that the bank will face over the forecast period will be regarding maintenance of asset quality, which according to our forecast may take another small dip before eventual recovery.

KFH's NPLs ratio is anticipated to increase to 13.0% in 2009 and 2010 owing to concerns regarding the bank's exposure to the financial institutions (FIs), the real estate sector. FIs in Kuwait are still undergoing a tough time with most companies having reported losses for the 1Q09 and expectations regarding a similar fate for the full year are rampant. The real estate sector prices in Kuwait, as per market research, have fallen approximately 6%QoQ in 1Q09 after falling around 10% - 30%YoY in 2008. KFH has made progress in its court proceedings against the rules 8 and 9 of May 2008 that placed certain restrictions on real estate transactions, including trading and usage of real estate as collateral for borrowing. While, this might offer benevolent prospects towards easing transactions, the risks associated with the sector are only partially mitigated. While KFH does not disclose details of its real estate investments, any exposure to the real estate market (in terms of loans or investments) in the UAE may adversely impact the bank's bottom-line. In short, in the medium term no respite can be expected from these two economic segments.

We believe that going forward, KFH's balance sheet growth will remain in check with marginal growth expected for 2009. Balance sheet expansion is expected to pick up in the years following, depending on the revival in the economy and the level of business confidence. We have nevertheless remained conservative in our estimates regarding the growth in the balance sheet.

KFH's top-line is anticipated to exhibit a slower but very healthy and sustainable growth owing to slower growth in earning assets and spreads that are expected to remain between 4.9% and 5.1% over the forecast period. Furthermore, an analysis of the bank's earnings quality since the start of the decade reveals that investment income has remained 30% - 50% of the total operating income, which is huge by any means. KFH's earnings have historically shown dependence over investment income which is by nature not as recurring as core income. Albeit, investment income has been a big part of the bank's earnings, we feel more comfortable in reducing it to the levels of 20 – 25% in our forecasts. A healthy growth in investment income in the range if 20 – 25%YoY may therefore ensue leading to a similar growth in the total non-commission income.

We expect the bottom-line to exhibit a profitability decline of 20%YoY in 2009 owing to higher provisions, lower non-commission income and stagnancy in the top-line. High growth in the earnings is then expected to ensue, driven by improving net commission income, higher investment income pushing growth in the non-commission income, and a decline in the provision requirements as asset quality improves and the need to provide coverage declines. The bank is therefore anticipated to exhibit an earnings CAGR of 20% over the forecast period.

Valuation & Recommendation

For arriving at the fair value of KFH, we have used two valuation methods:

1. Cash flow approach represented by the Dividend Discounting Model.

2. P/BV target multiple approach using an adaptation of the Gordon Growth Model.

Dividend Discounting Model - DDM

The DDM is based on a 4-year forecast of dividends as cash flows (2009-12). The dividends for the forecasted period and the terminal value are then discounted back at the cost of equity to arrive at the total net present value (NPV) of the company. In our calculations, we have made the following assumptions in order to arrive at the equity value of individual banks:

1. Cost of Equity derived using Capital Asset Pricing Model comes out to be 12.5% based on the following assumptions:

   a. Risk free rate of 6.5%.
   b. Market risk premium of 6.0%.
   c. Since Beta of 5 years monthly figures is less than 1.0, we will take it as 1.0.

2. Terminal growth rate of 3.5%.

Table 05: DDM Valuation

('000 KD)		2009E	2010E	2011E	2012E	Terminal Value
Dividends Expected		82,764	140,993	195,826	250,092	1,886,819
NPV of dividends expected	504,006					
NPV of Terminal Value	1,886,819					
Estimated Fair Value of Equity	2,390,825					
No. of Outstanding Shares (mn)	2,305					
COE	12.52%					
DDM Value of KFH per share (KD)	**1.04**					

Source: ***Global*** *Research*

Sensitivity - DDM

We have also prepared a sensitivity analysis for the estimated fair price based on various terminal growth rates and COE.

Table 06: DDM Sensitivity

		Terminal Growth Rate				
		2.5%	**3.0%**	**3.5%**	**4.0%**	**4.5%**
Cost of Equity	**11.5%**	1.06	1.11	1.17	1.24	1.32
	12.0%	1.00	1.05	1.10	1.16	1.23
	12.5%	0.95	0.99	**1.04**	1.09	1.15
	13.0%	0.90	0.94	0.98	1.03	1.08
	13.5%	0.86	0.89	0.93	0.97	1.01

Source: ***Global*** *Research*

Gordon Growth Model - GGM

The adaptation of the Gordon Growth model uses the sustainable return on average equity (ROAE), cost of equity (COE) and expected growth in earnings (g) to calculate the target P/BV of the bank using the formula:

$$P/BV = (ROE - g) / (COE - g)$$

This P/BV is then multiplied with the BVPS of the bank at the next full year, in our case the BVPS at December 31, 2009 to arrive at the fair value of the bank over a medium term investment horizon.

In our calculations, we have made the following assumptions in order to arrive at the equity value of individual banks:

1. Sustainable ROE is estimated by studying the future and historic trends of the ROE

2. Cost of Equity derived using Capital Asset Pricing Model taking the same assumptions as in the DDM.

3. Terminal growth rate of 3.5%, similar to the DDM.

Table 07: Gordon Growth Model

KD	
Sustainable ROE	22.0%
COE	12.5%
Terminal Growth Rate (g)	3.50%
2009: P/BV target multiple (x)	2.1
2009: BV/share	0.51
GGM Value of KFH per share	**1.04**

*Source: **Global** Research*

Sensitivity - GGM

We have also prepared a sensitivity analysis for the estimated fair price based on various terminal growth rates and COE.

Table 08: GGM Sensitivity

		Terminal Growth Rate				
		2.5%	**3.0%**	**3.5%**	**4.0%**	**4.5%**
Cost of Equity	**11.5%**	1.09	1.13	1.17	1.21	1.26
	12.0%	1.04	1.07	1.10	1.14	1.18
	12.5%	0.98	1.01	**1.04**	1.07	1.10
	13.0%	0.94	0.96	0.98	1.01	1.04
	13.5%	0.89	0.91	0.93	0.96	0.98

*Source: **Global** Research*

This sensitivity shows the movement in fair value as a consequence of different ROE and COE assumptions.

Table 09: GGM Sensitivity

		ROE				
		20.0%	**21.0%**	**22.0%**	**23.0%**	**24.0%**
Cost of Equity	**11.5%**	1.04	1.10	1.17	1.23	1.29
	12.0%	0.98	1.04	1.10	1.16	1.22
	12.5%	0.93	0.98	**1.04**	1.09	1.15
	13.0%	0.88	0.93	0.98	1.04	1.09
	13.5%	0.83	0.88	0.93	0.98	1.03

*Source: **Global** Research*

Based on the current market price of KD1.36/share (June 10, 2009), KFH is trading at 2009E P/E and P/BV multiple of 25.0x and 2.7x respectively.

Table 10: Valuation (KD)

Method	**Value**	**Weight**	**Weighted Value**
DDM	1.04	80%	0.83
GGM	1.04	20%	0.21
Fair Value			**1.04**

*Source: **Global** Research*

Our estimated value for this banking scrip is worked out to be **KD1.04** based on DDM (80%) and adaptation of the Gordon Growth Model (20%). According to our fair value the banking scrip offers a downside of 23.7% over the closing price. We therefore downgrade our recommendation on the scrip from HOLD to **SELL**.

BALANCE SHEET

	KUWAIT FINANCE HOUSE						
Amount in Kuwaiti Dinar'000	**2006**	**2007**	**2008**	**2009 (F)**	**2010 (F)**	**2011 (F)**	**2012 (F)**
Assets:							
Bank & cash equivalents	231,996	553,565	368,062	454,800	555,932	431,189	394,060
Short Term Intl. Murabaha incl Exchange of Deposits	651,145	307,464	1,312,153	1,403,998	1,474,198	1,420,590	1,715,363
Gross Receivables	2,942,621	4,139,486	5,078,895	5,551,263	6,082,197	7,518,508	8,548,477
Leased Assets	661,025	949,445	1,209,499	1,321,990	1,426,688	1,763,601	2,005,198
Investments	793,889	1,237,377	1,488,098	1,339,288	1,580,360	1,817,414	2,090,026
Trading Properties	90,463	126,413	57,590	46,072	50,679	55,747	61,322
Investment Properties	207,423	247,300	279,574	217,426	232,772	267,481	416,897
Property and Equipment	384,989	407,488	591,339	716,929	751,197	802,697	868,105
Other assets	128,327	239,694	485,713	398,285	418,199	439,109	373,243
Less : provision	(177,541)	(170,143)	(326,781)	(509,246)	(647,450)	(765,052)	(878,247)
Total Assets	**6,313,791**	**8,797,916**	**10,544,142**	**10,940,803**	**11,924,773**	**13,751,285**	**15,594,443**
Liabilities:							
Deposits from banks and FIs	1,080,004	1,186,391	1,595,452	1,276,362	1,340,180	1,420,590	1,491,620
Depositors Accounts	3,729,930	5,361,155	6,611,556	7,209,135	7,930,049	9,499,538	10,924,468
Other liabilities	289,325	380,853	394,033	425,556	446,833	469,175	563,010
Total Liabilities	**5,099,259**	**6,928,399**	**8,601,041**	**8,911,053**	**9,717,062**	**11,389,303**	**12,979,099**
Deferred Revenues	299,263	374,608	344,426	413,311	421,577	430,009	516,011
Minority Interest	137,443	196,094	354,545	369,021	396,548	444,131	503,604
Fair Value Reserve	66,654	86,843	11,394	(10,547)	44,194	48,613	53,475
Foreign Exchange Translation Reserve	8,683	1,972	(7,548)	9,748	9,748	9,748	9,748
Owner's Equity:							
Paid-up Equity Capital	122,525	171,535	205,842	230,543	230,543	230,543	230,543
Proposed Issue of Bonus Share	18,379	34,307	24,701	-	-	-	-
Statutory Reserve	186,115	214,589	223,285	229,564	239,296	252,298	268,551
Share premium reserve	188,788	464,735	464,766	464,766	464,766	464,766	464,766
Voluntary Reserve	116,843	208,093	241,973	254,530	273,994	299,997	332,503
Treasury Shares	-	1,006	(6,645)	(18,186)	(18,186)	(18,186)	(18,186)
Employee Share Options Reserves	-	4,237	4,237	4,237	4,237	4,237	4,237
Proposed cash dividends	69,839	111,498	82,125	82,764	140,993	195,826	250,092
Total Shareholder's Equity	**702,489**	**1,210,000**	**1,240,284**	**1,248,217**	**1,335,643**	**1,429,481**	**1,532,506**
Total Equity & Liabilities	**6,313,791**	**8,797,916**	**10,544,142**	**10,940,803**	**11,924,773**	**13,751,285**	**15,594,443**

*Source: Annual Reports, **Global** Research*

OPERATING STATEMENT

	KUWAIT FINANCE HOUSE						
Amount in Kuwaiti Dinar'000	**2006**	**2007**	**2008**	**2009 (F)**	**2010 (F)**	**2011 (F)**	**2012 (F)**
Murabaha, Istisna and Leasing Income	327,523	466,893	561,271	552,785	632,068	767,478	927,787
Payment to Depositors	(176,362)	(242,528)	(216,800)	(197,458)	(247,625)	(336,454)	(446,608)
Net Commission Income	**151,161**	**224,365**	**344,471**	**355,327**	**384,443**	**431,024**	**481,179**
Add : Fees and Commission	44,008	56,125	70,140	77,035	83,982	99,191	122,799
Add : Foreign Exchange Gains	3,332	14,696	13,547	11,921	12,517	13,769	15,146
Add : Investments Income	183,249	266,397	209,897	125,938	151,126	188,907	226,689
Add : Other operating income	20,875	27,037	29,998	32,998	36,958	42,501	48,876
Less : Provisions for loan & non cash credit facilities	(27,180)	(23,083)	(162,327)	(193,116)	(142,823)	(122,276)	(117,714)
Less : Provisions for investment losses	-	(15,096)	(48,613)	(12,547)	-	-	-
Operating income	**375,446**	**550,441**	**457,114**	**397,557**	**526,203**	**653,117**	**776,976**
Less : General & Admnistration Expenses	(111,132)	(121,917)	(167,128)	(150,805)	(187,327)	(217,110)	(250,513)
Less: Murabaha and Ijarah costs	(32,041)	(65,712)	(81,194)	(69,015)	(75,916)	(81,990)	(88,549)
Less: Depreciation	(33,754)	(27,939)	(28,547)	(32,976)	(33,565)	(36,802)	(41,424)
Operating profit	**198,519**	**334,873**	**180,245**	**144,761**	**229,394**	**317,215**	**396,490**
Minority Interest	31,226	50,129	17,692	14,476	27,527	47,582	59,474
Net Profit After Minority Interest	**167,293**	**284,744**	**162,553**	**130,285**	**201,867**	**269,633**	**337,017**
Less : Contribution to KFAS	(1,673)	(2,847)	(1,626)	(1,303)	(2,019)	(2,696)	(3,370)
Less: NLST & Zakat	(3,465)	(6,431)	(3,807)	(3,257)	(5,047)	(6,741)	(8,425)
Less : Directors' fees	(150)	(200)	(160)	(160)	(160)	(160)	(160)
Net Profit attributable to shareholders	**162,004**	**275,266**	**156,960**	**125,565**	**194,642**	**260,036**	**325,061**
Op Balance of Reserves	-	-	-	-	-	-	-
Cash Dividends paid	(60,168)	(69,839)	(111,498)	(82,125)	(82,764)	(140,993)	(195,826)
Net Movement in Treasury Shares	974	1,310	(7,651)	(11,541)	-	-	-
Net Profit for the year	162,004	275,266	156,960	125,565	194,642	260,036	325,061
Trfr to Statutory Reserve	16,729	28,474	8,697	6,278	9,732	13,002	16,253
Trfr to Voluntary Reserve	57,057	100,987	33,880	12,557	19,464	26,004	32,506
Cash Dividend	69,839	111,498	82,124.5	82,764	140,993	195,826	250,092
Issue of Bonus shares	18,379	34,307	24,701	-	-	-	-
Cl Balance of Retained Earnings	-	-	-	-	-	-	-

*Source: Annual Reports, **Global** Research*

CASH FLOW STATEMENT

	KUWAIT FINANCE HOUSE						
Amount in Kuwaiti Dinar'000	**2006**	**2007**	**2008**	**2009(F)**	**2010(F)**	**2011(F)**	**2012(F)**
Operating							
Operating Activities	**108,041**	**184,357**	**260,271**	**364,204**	**371,029**	**419,114**	**484,199**
Profit from operations	162,004	275,266	156,960	125,565	194,642	260,036	325,061
Depreciation	33,754	27,939	28,547	32,976	33,565	36,802	41,424
Minority Interest	31,226	50,129	17,692	-	-	-	-
Dividend income and gain on associates and AFS	(89,013)	(160,694)	(153,868)	-	-	-	-
Share of results of associates	(51,085)	(45,422)	-	-	-	-	-
Share of accumulated Retained Earnings of newly consolidated subsidiaries	(6,025)	(1,040)	-	-	-	-	-
Provision for loans & investment securities	27,180	38,179	210,940	205,663	142,823	122,276	117,714
Working Capital	**418,584**	**(128,368)**	**855,400**	**(209,511)**	**79,303**	**(69,596)**	**165,232**
Dec/(inc.) in international Murabaha	4,727	(6,224)	(6,633)	(91,845)	(70,200)	53,607	(294,773)
Dec/ (inc) Receivables	(972,881)	(1,593,999)	(483,769)	(472,368)	(530,934)	(1,436,311)	(1,029,969)
(Increase) / Decrease in Leased assets	(44,606)	(288,420)	(260,055)	(123,141)	(109,317)	(341,586)	(246,116)
(Increase) / decrease in Trading Properties	2,546	(35,950)	68,823	11,518	(4,607)	(5,068)	(5,575)
Dec/ (inc) Other assets	(71,126)	(116,626)	(246,348)	87,428	(19,914)	(20,910)	65,866
Inc/(dec) from banks & other financial institutions	798,387	106,386	409,062	(319,090)	63,818	80,411	71,030
Inc/(dec) of deposits from customers	540,586	1,631,224	1,250,401	597,579	720,914	1,569,489	1,424,931
Inc/(dec) other liabilities	96,927	99,893	154,104	31,523	21,278	22,342	93,835
Deferred Revenue	64,024	75,348	(30,185)	68,885	8,266	8,432	86,002
Total Operating	**526,625**	**55,989**	**1,115,671**	**154,693**	**450,332**	**349,518**	**649,431**
Investing							
Capex	(264,812)	(32,769)	(211,039)	(158,436)	(67,709)	(88,022)	(105,627)
Change in investments	53,728	(226,441)	(260,261)	114,322	(186,331)	(232,635)	(267,751)
Change of Investment Properties	(70,020)	(57,360)	(31,104)	62,019	(15,471)	(34,989)	(150,621)
Dividends received	-	-	26,789	-	-	-	-
Total Investing	**(281,104)**	**(316,570)**	**(475,615)**	**17,904**	**(269,511)**	**(355,646)**	**(523,998)**
Financing							
Dividend paid to shareholders	(60,168)	(69,839)	(111,498)	(82,125)	(82,764)	(140,993)	(195,826)
Capital Increase	-	306,312	-	-	-	-	-
Cash Received on cancellation of Share options	323	266	31	-	-	-	-
Minority Interest	-	-		14,476	27,527	47,582	59,474
Acquisition of own shares	-	-	-	(11,541)	-	-	-
Payment of Zakat	(5,091)	(5,804)	(7,557)	(23,967)	(24,452)	(25,204)	(26,210)
Proceeds from disposal of own shares	974	1,310	(7,651)	-	-	-	-
Total Financing	**(63,962)**	**232,245**	**(126,675)**	**(103,156)**	**(79,688)**	**(118,615)**	**(162,562)**
Net Cash & equivalents at beginning	701,582	883,141	854,806	368,062	454,800	555,932	431,189
Net Change in Cash	181,559	(28,336)	513,381	86,738	101,133	(124,743)	(37,130)
Net Cash & equivalents at end	**883,141**	**854,806**	**368,062**	**454,800**	**555,932**	**431,189**	**394,060**

*Source: Annual Reports, **Global** Research*

FACT SHEET

	KUWAIT FINANCE HOUSE						
	2006	2007	2008	2009F	2010F	2011F	2012F
Profitability							
- Return on Average Assets	2.9%	3.6%	1.6%	1.2%	1.7%	2.0%	2.2%
- Return on Average Equity	27.6%	31.8%	13.9%	10.8%	16.5%	21.4%	25.8%
- Net Ijara, Murabaha etc Income/ Total Op. Income	40.3%	40.8%	75.4%	89.4%	73.1%	66.0%	61.9%
- Non-Commission income/ total Op. Income	67.0%	66.2%	70.8%	62.4%	54.1%	52.7%	53.2%
- Non-Commission expense/ total Op. Income	47.1%	39.2%	60.6%	63.6%	56.4%	51.4%	49.0%
- Commissions/ total Op. Income	11.7%	10.2%	15.3%	19.4%	16.0%	15.2%	15.8%
- Dividend payout ratio	43.1%	40.5%	52.3%	65.9%	72.4%	75.3%	76.9%
Margins							
- Net income/ Revenues	49.5%	59.0%	28.0%	22.7%	30.8%	33.9%	35.0%
- Commission Expense to Commission Income	53.8%	51.9%	38.6%	35.7%	39.2%	43.8%	48.1%
-Commission Income to Commission Earning Assets	8.3%	8.9%	8.5%	7.4%	7.9%	8.4%	8.7%
- Commission Expense to Commission Bearing Liabilities	4.3%	4.3%	2.9%	2.4%	2.8%	3.3%	3.8%
- Net Spread	4.1%	4.7%	5.5%	5.0%	5.1%	5.1%	4.9%
- Net Commission Margin	3.9%	4.3%	5.2%	4.7%	4.8%	4.7%	4.5%
Efficiency							
-Cost to Total Op Income	43.9%	36.6%	41.4%	41.9%	44.4%	43.3%	42.5%
- General & Administration Expense to Total Op Income	27.6%	20.7%	25.0%	25.0%	28.0%	28.0%	28.0%
- Cost to Average Total Assets	3.2%	2.9%	2.9%	2.4%	2.6%	2.6%	2.6%
Liquidity							
- Loans to Income Earning Assets	71.9%	76.6%	73.8%	69.9%	70.5%	76.4%	74.4%
- Loans to Customer Deposits	78.9%	77.2%	76.8%	77.0%	76.7%	79.1%	78.3%
- Customer Deposits to Equity	531%	443%	533%	578%	594%	665%	713%
Credit Quality							
- Provisions to Total Operating Income	7.2%	6.9%	46.1%	51.7%	27.1%	18.7%	15.2%
- Provisions to Average Receivables	6.8%	4.8%	7.1%	9.6%	11.1%	11.3%	10.9%
- Non Performing Loans (NPLs) KD'000	120,224	156,031	642,168	721,664	790,686	827,036	854,848
- Loan Loss Reserve (Provisions) KD'000	177,541	170,143	326,781	509,246	647,450	765,052	878,247
- NPL's to Gross Loans	4.1%	3.8%	12.6%	13.0%	13.0%	11.0%	10.0%
- NPL Coverage	136.8%	97.0%	46.6%	66.7%	78.4%	89.2%	99.5%
Capital Adequacy							
- Equity to Total Assets	11.1%	13.8%	11.8%	11.4%	11.2%	10.4%	9.8%
- Equity to (Total Assets + Cont. Liabilities)	10.9%	13.6%	11.6%	11.3%	11.1%	10.3%	9.8%
- Equity to Gross Receivables	23.9%	29.2%	24.4%	22.5%	22.0%	19.0%	17.9%
Constitution of Total Income							
- Net Commission Income to Total Op Income	37.5%	38.1%	51.6%	58.9%	57.5%	55.6%	53.8%
- Fees & Comm. to Total Op. Income	10.9%	9.5%	10.5%	12.8%	12.6%	12.8%	13.7%
- Investment Income to Total Op Income	45.5%	45.3%	31.4%	20.9%	22.6%	24.4%	25.3%
- FX Income to Total Op. Income	0.8%	2.5%	2.0%	2.0%	1.9%	1.8%	1.7%
- Other Income to Total Op. Income	5.2%	4.6%	4.5%	5.5%	5.5%	5.5%	5.5%
Operating Performance							
- Change in Net Murabahas, Istisna and Leasing Income	234.2%	62.3%	-9.5%	-10.9%	49.0%	27.8%	17.7%
- Change in Fees and Commission	31.9%	27.5%	25.0%	9.8%	9.0%	18.1%	23.8%
- Change in Investment Income	30.5%	37.1%	-35.8%	-29.7%	33.3%	25.0%	20.0%
- Change in Fx Income	-46.4%	341.1%	-7.8%	-12.0%	5.0%	10.0%	10.0%
- Change in Other Income	56.4%	29.5%	11.0%	10.0%	12.0%	15.0%	15.0%
RATIOS USED FOR VALUATION							
- Dividend Payout (%)	43.1	40.5	52.3	65.9	72.4	75.3	76.9
- Shares in Issue (mn)	1,225.3	1,715.4	2,058.4	2,305.4	2,305.4	2,305.4	2,305.4
- EPS (fils)	132.2	160.5	76.3	54.5	84.4	112.8	141.0
- Adjusted EPS (fils)	70.3	119.4	68.1	54.5	84.4	112.8	141.0
- Book Value Per Share (fils)	516.3	640.4	562.6	505.5	518.2	535.1	556.3
- Adjusted Book Value Per Share (fils)	274.4	476.5	502.4	505.5	518.2	535.1	556.3
- Market Price Year End (fils)	2,180	2,880	1,760	1,360	1,360	1,360	1,360
- Market Cap (KD mn)	2,671.0	4,940.2	3,622.8	3,135.4	3,135.4	3,135.4	3,135.4
- P/E	16.5	17.9	23.1	25.0	16.1	12.1	9.6
- P/BV	4.2	4.5	3.1	2.7	2.6	2.5	2.4

Historical P/E & P/BV multiples pertain to respective year -end prices, while those for future years are based on closing prices as of June 10, 2009.
*Source: **Global** Research*

The following is a comprehensive list of disclosures which may or may not apply to all our researches. Only the relevant disclosures which apply to this particular research has been mentioned in the table below under the heading of disclosure.

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Company	Recommendation	Ticker	Price	Disclosure
Kuwait Finance House	Sell	KFIN.KW (Reuters) KFIN KK (Bloomberg)	KD1.36	1, 10

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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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