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EFG HERMES

KUWAIT FINANCE HOUSE

3Q2009 Results - Still Some Question Marks on Credit Quality

03 NOVEMBER 2009

KUWAIT | BANKING

Short-Term Rec.: Neutral	Current Price*: KWD 1.16
Long-Term Rec. : Neutral	LT Fair Value : KWD 1.39

• **3Q2009 Net Profit 11% Above Estimates on Lower Minority Expense:** KFH reported a 3Q2009 net profit of KWD34.3 million, down 46% Y-o-Y but up 5% Q-o-Q. 3Q2009 earnings were 11% ahead of our forecast, primarily due to a lower-than-expected minority charge. Net profit before minorities fell by 58% Y-o-Y, and was 12% below expectations. The main negative surprise in the results was revenue, which was down 3% Y-o-Y and 18% Q-o-Q, and underperformed our estimate by 21%. However, operating expenses and provisioning charges were both better than expected.

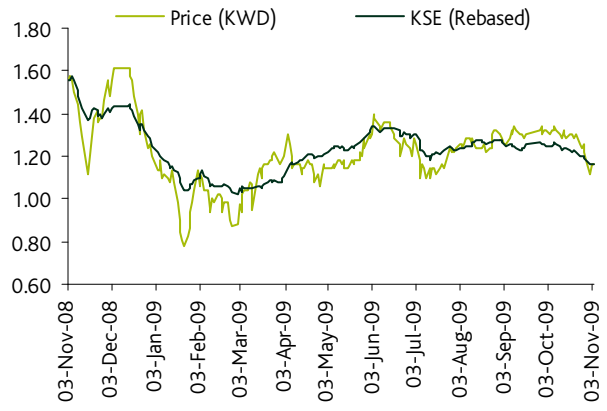
• **Asset Growth Muted, as Expected:** Customer deposits increased by 2% Q-o-Q and by 11% Y-o-Y, and were just 1% shy of expectations. Customer assets (receivables and leased assets) were flat Q-o-Q and rose 6% Y-o-Y, marginally below expectations. KFH's 3Q2009 asset growth was broadly in line with sector trends. According to the Central Bank of Kuwait's statistics, overall customer deposits fell by 0.7% Q-o-Q in September 2009, while total customer loans inched up 1% Q-o-Q.

• **Revenues Miss Forecasts:** Revenues missed expectations by 21%, with net interest income (6% below our forecast) and investment and property income (32% lower than our forecast) being the main areas of disappointment. Net interest income increased by 27% Y-o-Y, driven by a significant Y-o-Y decline in interest expense, and despite a fall in income from receivables and other assets. Quarterly interest expense is however only an estimate of the expected distribution to depositors, as the final amount is only fixed after the year-end financial statements have been approved. Fee income fell by 14% Y-o-Y, although it grew by 10% Q-o-Q with a weak 2Q2009 comparable. Investment and property income delivered a poor performance, shrinking by 32% Y-o-Y and 47% Q-o-Q.

• **Costs Reverse to Normal Quarterly Trend; Provisioning Declines Q-o-Q:** Operating expenses increased 18% Y-o-Y, although they declined 21% Q-o-Q following a high expense base in 2Q2009. Costs were 19% below expectations. Provisioning charges surged four-fold Y-o-Y, but declined by 38% Q-o-Q, and were 30% below expectations. KFH has not disclosed NPL data since December 2008, and management guidance on this particular issue remains scarce. If we assume that NPLs have remained unchanged since 2008 year-end (NPL ratio stood at 12.6% in 2008), we estimate that the coverage ratio (ex-collateral) has improved only slightly to 50% in September 2009, from 47% in December 2008.

• **Forecasts and Recommendation Unchanged:** With net profit for 9M2009 accounting for 85% of our FY2009e forecast of KWD125 million, our earnings estimates now seem to be on the conservative side. However, given the weak visibility we have on credit quality for both KFH and Kuwait as a whole, and given our estimate of a low coverage ratio, we cannot discount the possibility of a large provisioning charge in 4Q2009e. We are therefore leaving our earnings estimates unchanged. We also reiterate our ST/LT Neutral on the stock. Following the recent weak share price performance, our LTFV estimate offers 19% upside potential. We are nevertheless not inclined to turn more positive on the shares for now.

FLASH NOTE



	2009e	2010e	2011e
EPS	0.054	0.071	0.104
P/E* (x)	21.4	16.4	11.2
DPS	0.021	0.028	0.036
Div Yield	1.8%	2.4%	3.1%
BVPS	0.536	0.578	0.646
P/BV* (x)	2.2	2.0	1.8

In KWD, unless otherwise stated

Stock Data	
Last Dividend Date	KWD0.04 on11 Mar 09
Mkt. Cap / Shares (mn)	KWD2,764 / 2,305
Av. Mthly Liqdty (mn)	KWD150
52-Week High / Low	KWD1.63 / 0.79
Bloomberg / Reuters	KFINKK / KFIN.KK
Est. Free Float	57%

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*Prices as at 03 November 2009

Figure 1: KFH's 3Q2009 Results, Main Highlights
In KWD million, unless otherwise stated

	3Q08	2Q09	3Q09a	3Q09e	Y-o-Y	Q-o-Q	Vs. Forecasts
Income from Receivables & Others	143	139	131	132	-8%	-5%	-1%
Estimat. Dist. to Depositors & Other Int. Exp.	(93)	(70)	(69)	(65)	-27%	-2%	6%
Net Interest Income	**49**	**69**	**63**	**67**	**27%**	**-9%**	**-6%**
Net Fees and Commissions	19	15	16	16	-14%	10%	0%
FX Income	1	(6)	3	2			
Investment and Property Income	48	62	33	60	-32%	-47%	-46%
Other Income	10	13	10	13			
Non-Interest Income	**78**	**83**	**61**	**91**	**-21%**	**-26%**	**-32%**
Total Banking Income	**128**	**152**	**124**	**158**	**-3%**	**-18%**	**-21%**
Operating Expenses	(50)	(74)	(59)	(73)	18%	-21%	-19%
Operating Profit	**78**	**78**	**65**	**85**	**-16%**	**-16%**	**-23%**
Total Provisions	(7)	(56)	(35)	(50)	407%	-38%	-30%
Extraordinary & Other	-	-	-	-			
Profit before Tax	**71**	**21**	**30**	**35**	**-57%**	**42%**	**-14%**
Taxes and Zakat	(3)	(1)	(1)	(2)			
Net Profit	**68**	**20**	**29**	**33**	**-58%**	**46%**	**-12%**
Minorities	(5)	13	5	(2)			
Net Profit after Minorities	**63**	**33**	**34**	**31**	**-46%**	**5%**	**11%**
Receivables	4,750	5,023	5,035	5,074	6%	0%	-1%
Deposits	6,333	6,864	7,015	7,070	11%	2%	-1%
Total Assets	10,543	10,801	11,000	10,998	4%	2%	0%
Shareholders' Equity	1,312	1,200	1,236	1,228	-6%	3%	1%
Net Interest Spread	2.65%	3.79%	3.43%	3.65%	30%	-9%	-6%
Costs to Income	39.0%	49.0%	47.4%	46.2%	22%	-3%	3%

Source: Kuwait Finance House, EFG-Hermes estimates

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