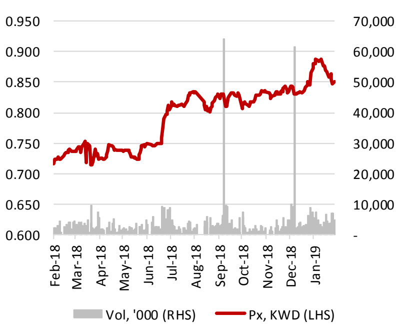
National Bank of Kuwait

TP : KWD 0.974 / share
Upside/ (Downside): 14.6%

Recommendation	**Accumulate**
Bloomberg Ticker	NBK KK
Current Market Price (KWD)	0.850
52wk High / Low (KWD)	0.890/0.705
12m Average Vol. (000)	3,507.5
Mkt. Cap. (USD/KWD mn)	17,178/5,206
Shares Outstanding (mn)	6,124.1
Free Float (%)	98%
3m Avg Daily Turnover (KWD mn)	4.0
6m Avg Daily Turnover (KWD mn)	3.6
PE 2019e (x)	13.7
PBv 2019e (x)	1.5
Dividend Yield '19e (%)	4.0%
Price Performance:	
1 month (%)	(1.73)
3 month (%)	1.80
12 month (%)	19.80

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

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- **Return on Tangible Common Equity Improvement story at a discounted valuation; Initiate with Accumulate**
- **Steadily improving return on average common equity (ROCEs): FY16: 10.5%, FY17: 10.9% and FY18: 12%.**
- **The most profitable bank in Kuwait with ROE at 12% vs. peer-group average of 10%**
- **Cost efficient with Cost-to-Income at 31.3% vs local peer group average at 48%**
- **Strong asset quality amid robust capital adequacy metrics**

We initiate our coverage on National Bank of Kuwait (NBK) with **Accumulate** and a 12-month target price (TP) of KWD 0.974 per share. Our TP implies a P/e'19e of 15.0x and a P/b'19e of 1.59x, which we believe is justified given the bank's improving profitability and strong efficiency, adequate capital strength and asset quality metrics comparable to other dominant banking franchises in the GCC. We think NBK can deliver steady profitability improvement through loan-book growth as well as net interest margin (NIM) improvement, reaching a 14.9% return on average tangible common equity (ROTCE) in 2019 from 14.4% in 2018.

Robust earnings growth outlook on the back of strong loan-book expansion

The expected loan growth will depend on Kuwait Government's mega projects that are expected to be implemented during 2019. In addition to that, the recent relaxation of personal lending restrictions by the Central Bank of Kuwait (CBK) is expected to provide impetus to private credit growth. In addition to that, the IMF expects Kuwait's real GDP to pick up to 2.5% and 2.9% in 2019e and 2020e respectively, from an estimated 1.7% in 2018. Therefore, we believe that credit growth in Kuwait will remain strong in 2019 and onwards, and we believe that NBK will be able to grow its net-loan book at a CAGR of about 6.1% over the forecast period. This is expected to translate into a net profit CAGR of 11.5% over 2019-2023e through rising net interest income amid stable operating expenses and declining provisions.

Profitability metrics set to improve amidst robust efficiency

The bank's net interest margin has been trending upwards and we expect this trend to continue during 2019 and onwards. However, whether Central Bank of Kuwait (CBK) will go ahead with raising its policy interest rates will depend on whether the US Fed goes ahead with the anticipated one or two interest rate hikes during 2019 as announced in last FOMC meeting. Nonetheless, we are expecting the bank's operating income to increase at a CAGR of 5.8% over the forecast period, which coupled with slower growth in operating expenses as the bank continues to maintain its efficiency metrics, will lead to a CAGR of 6.0% in the operating profit of the bank. As the bank's net profit grows, its ROE and ROA are expected to improve over the forecast period to averages of 13% and 1.5% respectively, over the next five years.

Strong asset quality and declining cost of risk (CoR)

Banks in Kuwait, including NBK, have been booking excessive general provisions since 2012 on CBK guidelines. With IFRS 9, banks have been using previously built buffers to write off Stage 2 loans that are expected to be impaired. From 2019 onwards, NBK would not have to book general provisions, resulting in a significant drop in its cost of credit risk. We expect cost of credit risk to fall from 109bps in 2018 to 99bps in 2019e and 88bps in 2020e. The bank boasts strong asset quality with Non-performing loan (NPL) ratio at 1.38% vs. local peer group average of 1.72%

Key Risks

Key downside risks are geo-political factors that might hamper loan-book growth through trickle-down effect from macroeconomic situation, an unexpected asset quality deterioration, and cost of risk to move higher instead of lower. Upside risks would arise from faster than expected loan-book growth and a better-than-expected NIM expansion.

Key Indicators

Year	FY16	FY17	FY18	FY19e	FY20e	FY21e
Total Net Loans (KWD mn)	13,611	14,503	15,503	16,953	17,969	19,064
Total Customer Deposits (KWD	12,608	13,780	14,389	15,918	16,774	17,848
Operating Income (KWD mn)	745	823	883	953	1,010	1,094
Net Profit (KWD mn)	295	322	371	417	467	523
Diluted EPS (KWD)	0.053	0.055	0.061	0.065	0.069	0.074
Tangible BVPS (KWD)	0.415	0.421	0.422	0.425	0.436	0.451
P/E (x)	12.7	10.6	13.8	13.7	12.8	12.0
P/BVPS (x)	1.1	1.0	1.4	1.5	1.4	1.4
Dividend Yield (%)	4.4%	5.1%	4.2%	4.0%	4.0%	4.0%

Source: Company Financials, U Capital Research

Valuation

We have used Excess Returns Methodology and Peer-Group Price-to-Book Multiple to arrive at a blended target price of National Bank of Kuwait (NBK). We have assigned 80% weightage to Excess Returns Methodology and 20% to Price-to-Book Multiple.

Beginning book value of Equity invested currently	**3,163,257**				
	31-Dec-19	**31-Dec-20**	**31-Dec-21**	**31-Dec-22**	**31-Dec-23**
KWD'000					
Net Income	**416,611**	**466,680**	**522,731**	**583,289**	**644,859**
Less: Equity Cost	354,443	377,634	405,627	438,838	477,674
Excess Equity Return	**62,168**	**89,046**	**117,104**	**144,451**	**167,185**
Present value of Excess Equity Return	56,568	72,861	86,164	95,576	99,472
Sum of present value of Excess Return	**410,640**				
Equity Cost					
Opening book value	**3,163,257**	**3,370,228**	**3,620,055**	**3,916,446**	**4,263,044**
Cost of Equity	11.2%	11.2%	11.2%	11.2%	11.2%
Equity Cost	354,443	377,634	405,627	438,838	477,674
Terminal value projections					
Book value of equity at start of year 6	**4,659,797**				
Net income in Stable period	675,671				
Less equity cost	522,130				
Excess return	153,540				
Terminal Value	4,163,641				
PV of Terminal Value	2,477,289				
Total Equity value , KWD'000	6,051,186				
Total shares out, '000	6,124,120				
Target Price, KWD	**0.988**				
Peer-Group Multiples Based Approach					
Average Peer-Group Price-to-Book (x) '19e	1.5				
NBK BVPS'19e	0.611				
Target Price, KWD	**0.916**				
Weighted-average Target Price, KWD	**0.974**				
Current Price, KWD	0.850				
Upside / (Downside), %	14.6%				

We have used risk-free rate of 3.48%, US risk premium of 7.5%, a 5-Yr monthly adjusted beta of 1.03 to arrive at the cost of equity of 11.21%. We have assumed a terminal ROE of 14.5% and a terminal sustainable growth rate of 7.3%.

Our target price implies a P/E'19e of 15.0x and a P/B'19e of 1.59x, which in our view, is justified given the bank's improving profitability and strong efficiency, capital strength and asset quality metrics comparable to other dominant banking franchises in the GCC.

Sensitivity Analysis

We have presented sensitivity analysis of our model to changes in cost of equity, stable period ROE and terminal growth rate. With all else constant, we can see that with one +/- movement of 0.1% in stable period ROE, our target price changes by +/-1.4%.

NBK

Cost of Equity	Stable Period ROE				
0.974	**14.3%**	**14.4%**	**14.5%**	**14.6%**	**14.7%**
10.7%	1.060	1.078	1.095	1.114	1.132
11.0%	0.999	1.014	1.030	1.046	1.062
11.2%	0.946	0.959	**0.974**	0.987	1.002
11.5%	0.898	0.910	0.923	0.936	0.949
11.7%	0.857	0.867	0.878	0.890	0.902

Cost of Equity	Terminal Growth Rate				
0.974	**7.1%**	**7.2%**	**7.3%**	**7.4%**	**7.5%**
10.2%	1.221	1.239	1.259	1.280	1.303
10.7%	1.070	1.082	1.095	1.109	1.123
11.2%	0.957	0.965	**0.974**	0.982	0.991
11.7%	0.868	0.874	0.878	0.885	0.890
12.2%	0.797	0.800	0.803	0.807	0.811

Source: U Capital Research

Similarly, keeping all else constant, with every +/-0.25% movement in cost of equity, our target price changes by +/-5%. Our target price is not sensitive to +/-0.1% changes in terminal growth rate.

Peer-Group Analysis

BBG Ticker	Name	Market Cap (KWD)	Price (LCY)	Current P/E (x)	P/E '19e (x)	Current P/B (x)	P/B'19e (x)	Current ROE (%)	ROE'19e (%)	Current Div Yield (%)	Div Yield '19e (%)
QNBK QD Equity	QATAR NATIONAL BANK	14,658	190.900	13.7	11.7	2.6	2.1	19.6%	19.1%	3.1%	3.1%
FAB UH Equity	FIRST ABU DHABI BANK PJSC	13,647	15.140	14.2	11.7	1.8	1.6	12.7%	15.1%	4.9%	4.9%
NCB AB Equity	NATIONAL COMMERCIAL BANK	13,099	53.900	15.6	13.3	2.8	2.4	18.1%	18.1%	4.1%	-
SAMBA AB Equity	SAMBA FINANCIAL GROUP	6,132	37.850	13.7	12.1	1.8	1.6	12.7%	14.0%	5.3%	5.0%
NBK KK Equity	**NATIONAL BANK OF KUWAIT**	**5,206**	**850.000**	**14.7**	**13.7**	**1.7**	**1.5**	**12.0%**	**12.8%**	**4.1%**	**4.0%**
RIBL AB Equity	RIYAD BANK	5,653	23.260	14.8	13.6	1.9	1.7	11.7%	12.4%	3.4%	3.3%
SABB AB Equity	SAUDI BRITISH BANK	4,514	37.150	11.3	11.2	1.7	1.5	13.5%	13.6%	5.4%	5.4%
EMIRATES UH Equity	EMIRATES NBD PJSC	4,735	10.300	6.1	5.6	1.0	0.8	18.1%	15.3%	3.9%	3.9%
ADCB UH Equity	ABU DHABI COMMERCIAL BANK	4,020	9.350	10.4	9.4	1.7	1.4	16.3%	15.6%	4.9%	4.9%
KFH KK Equity	KUWAIT FINANCE HOUSE	3,908	623.000	17.2	13.0	2.2	1.8	11.8%	14.4%	3.2%	-
BSFR AB Equity	BANQUE SAUDI FRANSI	3,466	35.500	12.8	9.8	1.3	1.2	10.9%	12.2%	4.5%	-
ARNB AB Equity	ARAB NATIONAL BANK	2,900	35.800	11.0	9.9	1.4	1.3	13.4%	12.4%	4.7%	4.7%
MARK QD Equity	MASRAF AL RAYAN	2,485	39.850	14.0	13.9	2.3	2.1	16.1%	16.6%	5.0%	5.0%
ALAWWAL AB Equity	ALAWWAL BANK	1,519	16.400	16.3	15.6	1.4	1.3	8.5%	8.3%	-	-
CBQK QD Equity	COMMERCIAL BANK PQSC	1,362	40.490	11.5	9.1	1.0	0.9	8.6%	11.1%	3.7%	3.7%
BOUBYAN KK Equity	BOUBYAN BANK K.S.C	1,365	572.000	27.1	19.1	3.3	2.6	13.0%	-	1.4%	-
UNB UH Equity	UNION NATIONAL BANK/ABU DHAB	1,177	5.170	9.7	8.8	0.8	0.8	8.6%	10.0%	3.9%	3.9%
SIBC AB Equity	SAUDI INVESTMENT BANK/THE	1,235	20.320	10.5	8.9	1.1	0.9	11.2%	10.8%	2.9%	3.4%
Median				**13.7**	**11.7**	**1.7**	**1.5**	**12.7%**	**13.8%**	**4.0%**	**4.3%**
Average				**13.5**	**11.6**	**1.8**	**1.5**	**13.2%**	**13.7%**	**4.0%**	**4.3%**

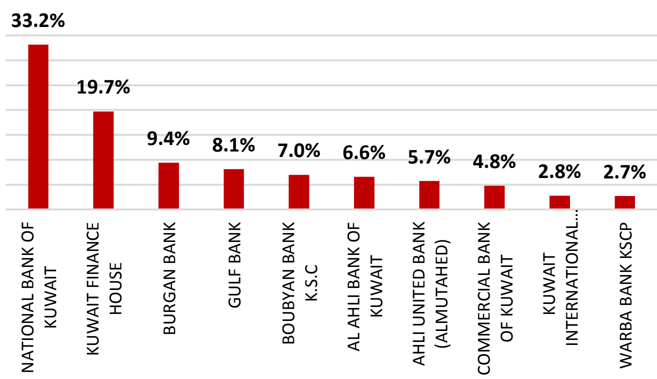
Source: Bloomberg, U Capital Research

Company Outlook

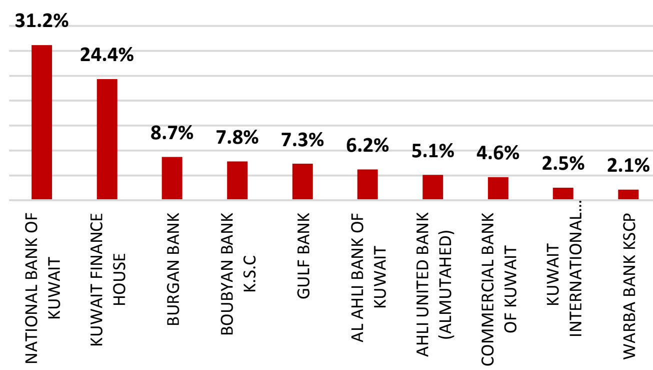
Net loans & Islamic financing to grow at a CAGR of 6.1% over 2019-2023e

In terms of loans & deposits, NBK has a leading share in both at about 33% and 31%[1] within Kuwait's listed banks. We are expecting NBK to grow its loan-book at a CAGR of 6.1%, which, in our view, is justified based on our expectation of improving overall credit and GDP growth.

Market Share of Net Loans, FY18



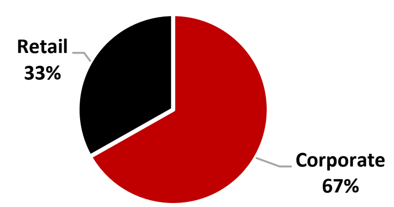
Market Share of Customer Deposits, FY18



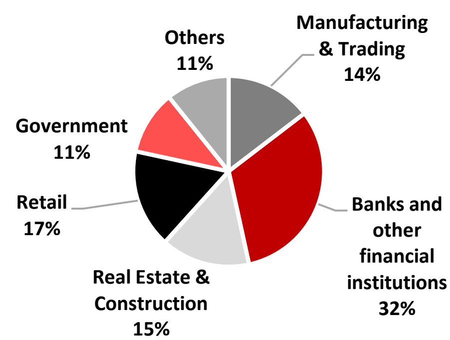
Source: Bloomberg

NBK aims to focus on Kuwait Government's mega projects leveraging its large capital base, maintain its current market share in trade finance at 30%, and focus on high net worth (HNW) clients through its extensive private banking network. The bank does not have any significant concentrations in its assets and off-balance sheet exposures, economic sector wise. Also, it does not have credit concentration by customer where the 20 largest loans, advances and Islamic Financing to customers form just 17% of total as at the end of FY18.

NBK: Customer Type for Loans, Advances & Islamic Finance, FY18



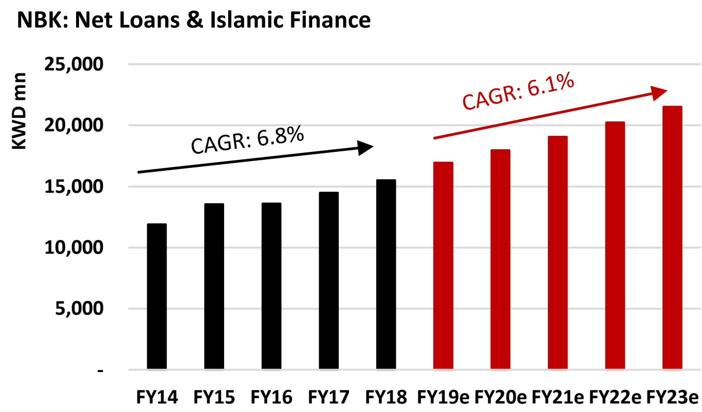
NBK: Economic Concentration of Assets & off-balance sheet exposure, FY18

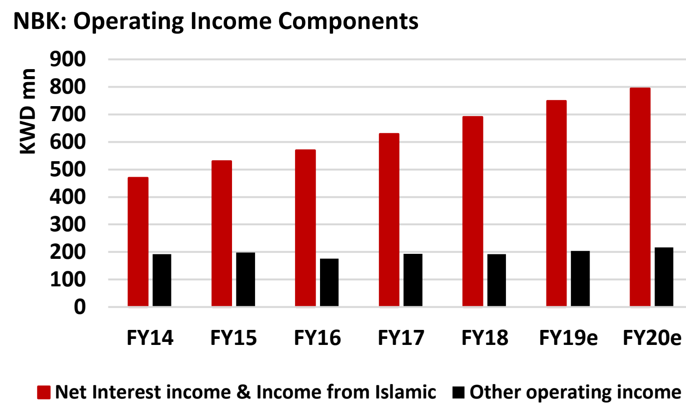


Source: Bank Financials, U Capital Research

Customer deposits of the bank are expected to grow at a CAGR of 6.0%, buoyed by improving liquidity prospects as current account balance of the country keeps on improving.

[1] Bloomberg

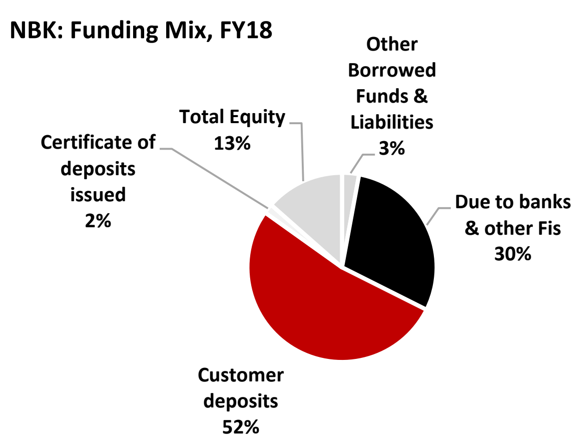


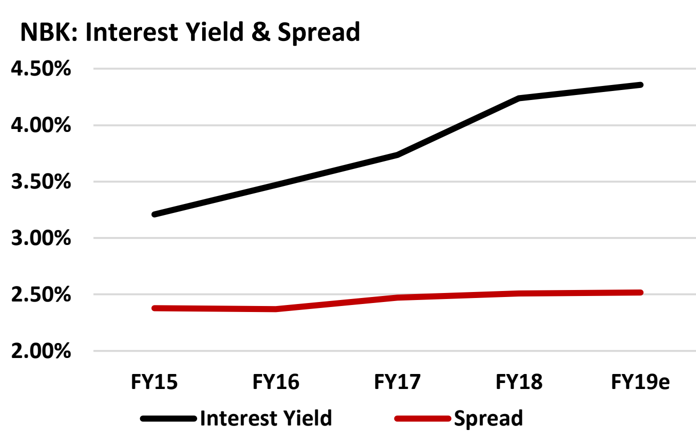


Source: Bank Financials, U Capital Research

Net Interest & Islamic Finance Income to grow at a CAGR of 6.0% over 2019-2023e

The bank's interest income has been consistently rising on net loan growth as well as improvement in spreads, characteristic of a rising interest rate environment. A little over half the bank's balance sheet is funded by customer deposits (c52%), and 61% of liabilities are comprised of customer deposits.





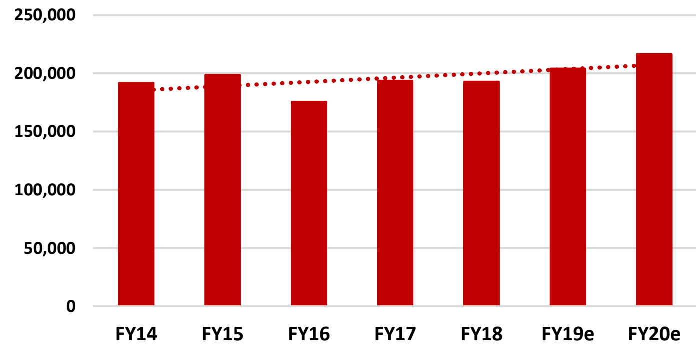
Source: Bank Financials, U Capital Research

During 2018, average NIMs improved to 2.69% in 2018. The NIM was impacted favorably by 43bps due to the combined movements attached to loans and other assets, whilst the higher cost of deposits impacted the NIM to the extent of 35bps, resulting in net improvement of 8bps. Going forward, we expect the NIMs to average around 2.75% during 2019-23e compared to historical average of 2.60% during 2016-18.

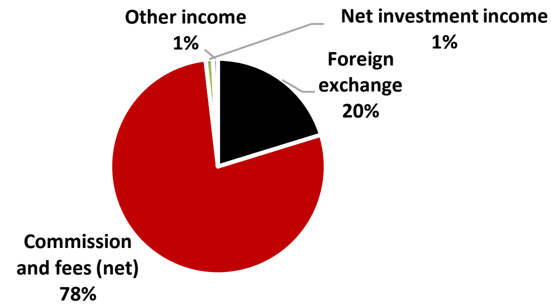
Other operating income also rising on expanding net fee as well as trading income

Other operating income, which constitutes about 22% of total operating income, has been relatively stable with occasional blips seen due to items other than net fee & commission. Net fee & commission income constitutes about 78% of total other operating income as of FY18. We are expecting other operating income to grow at a CAGR of 6.1% on account of growing net loans & Islamic finance and better investment income.

NBK: Other Operating Income



NBK: Other Operating Income constituents, FY18

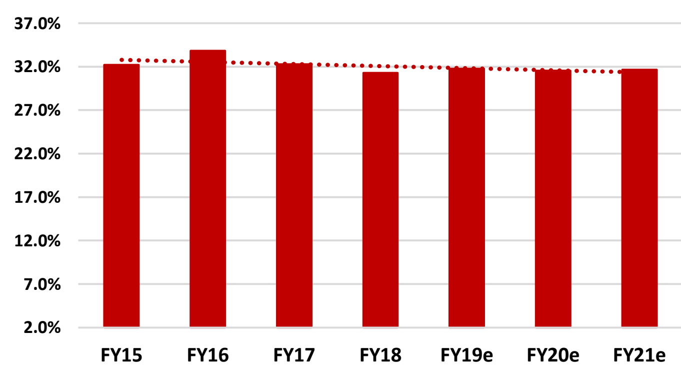


Source: Bank Financials, U Capital Research

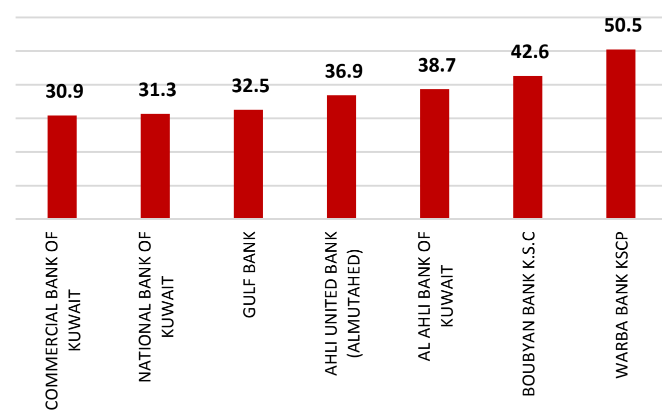
Superior efficiency metrics

The bank's operating expenses have been growing over the last few quarters, but the pace of growth has been slower than growth of operating income, resulting in cost to income ratio of the bank to decline from 32.3% in FY17 to 31.3% in FY'18. In FY18, staff costs grew by 3.6%YoY, and other operating expenses by 4.8%YoY. Costs have been rising as the bank continues to invest in long term sustainability capex.

NBK: Cost to Income Ratio



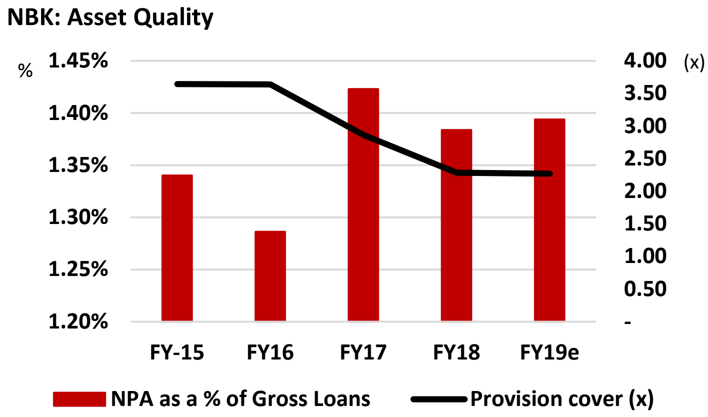
Peer Group Cost-to-Income Ratio, %

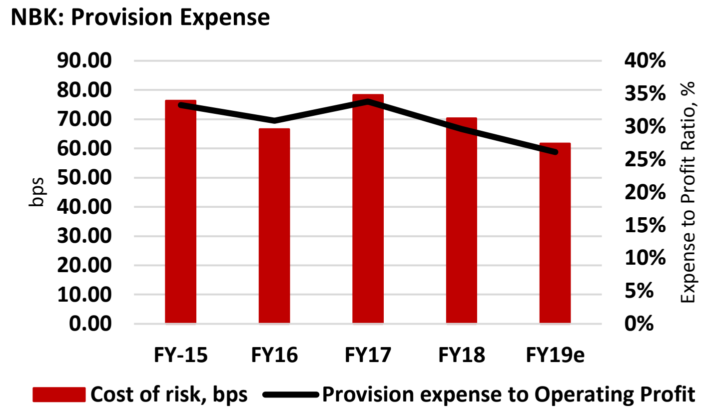


Source: Bank Financials, Bloomberg, U Capital Research

Asset Quality to remain intact; Cost of risk expected to fall on full adoption of IFRS9

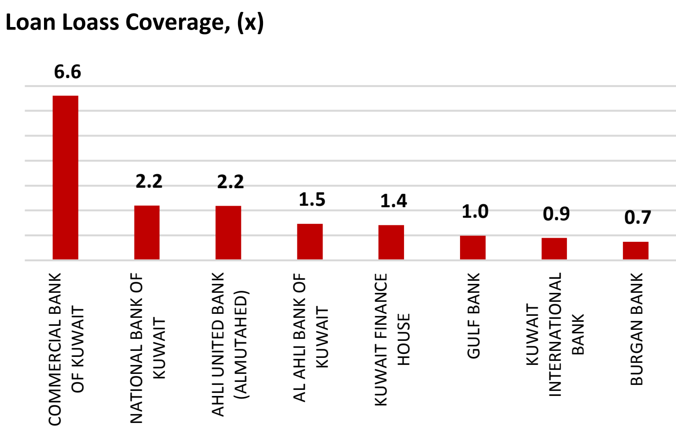
Overall, NBK's asset quality has always been healthy compared to its local as well as GCC peers. The bank's NPA to Gross Loans ratio actually improved in FY18 to 1.38% from 1.42% in FY17, as the bank carried out portfolio cleaning exercise and wrote off problem loans, ahead of full IFRS9 adoption. Its provision cover stands at a healthy ratio of 2.28x. We are conservatively estimating the bank's NPA to Gross Loans ratio to remain intact at the current level, although it has been falling since FY16.

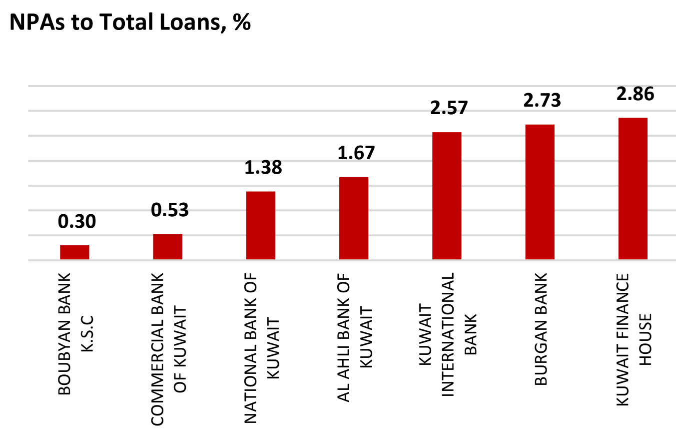




Source: Bank Financials, U Capital Research

Within its local peer group, NBK has a low NPA to total loans ratio, and has an above average provision cover.

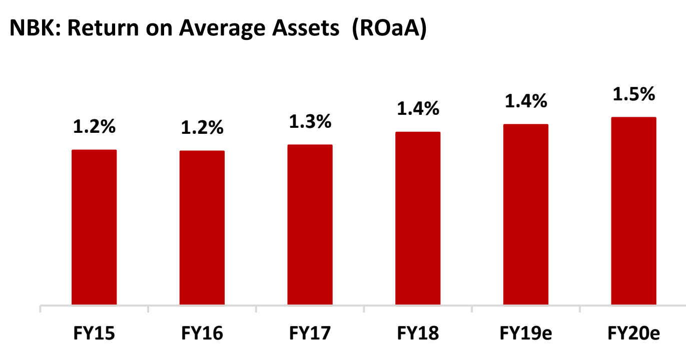


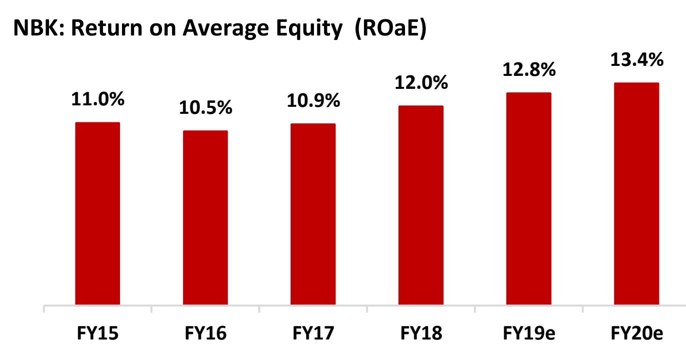


Source: Bloomberg

Net Profit to grow at a CAGR of 11.5% over 2019-2023e

NBK recorded exceptional growth in net income which was largely due to rise in domestic and international interest rates. Higher rates were conducive to supporting earnings growth at the Group. It was against the backdrop of increases in international rates that the Central Bank of Kuwait raised its benchmark discount rate during the year, albeit on just one occasion, in March. Going forward, we estimate a CAGR of 11.5% in the bank's net profit over the forecast horizon, driven by growing net interest income and declining provision expenses.





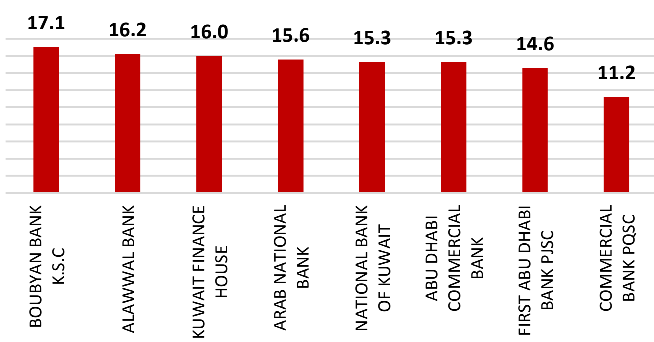
Source: Bank Financials, U Capital Research

NBK has strong profitability ratios, with return on average equity (ROaE) at 12% and return on average assets (ROaA) at 1.4%. Its profitability has consistently been improving over the last three years, and we expect this trend to continue and expect ROaE and ROaA to average around 13.7% and 1.6%, respectively during 2019-23e.

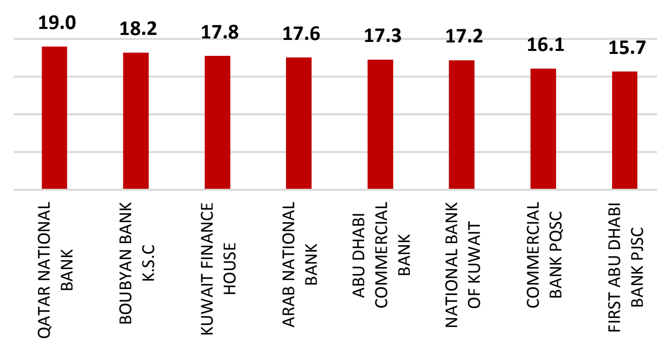
Strong capital adequacy

NBK boasts strong capital adequacy levels with Capital Adequacy Ratio (CAR) at 17.2% in 2018. This compares to 17.8% at year-end Dec'17. The partial transition to IFRS 9 (i.e. as applicable to financial assets other than credit facilities) at the commencement of 2018 served to impact the Groups opening ratio by approximately 16 basis points. The T1 and T2 capital ratio at year end was 15.3% and 1.9%, whilst its Common equity tier 1 capital ratio was 13.8%. Going forward, the bank has no immediate plans to raise capital.

Tier 1 Capital Ratio, %



Total Capital Adequacy Ratio (CAR), %

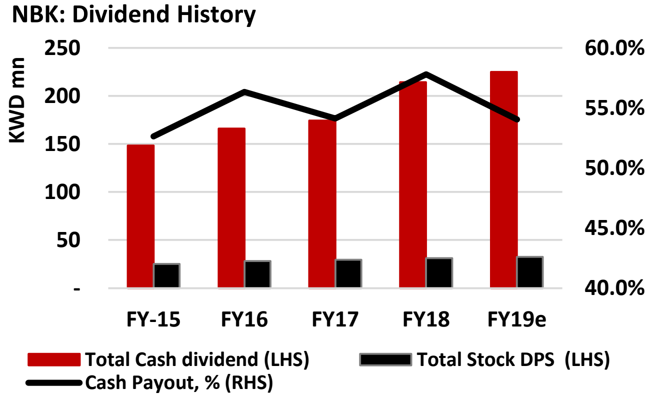


Source: Bloomberg

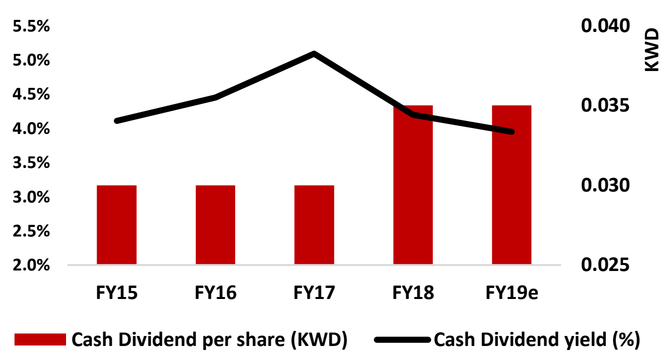
Dividend History

The Board of Directors of the bank has proposed a cash dividend of 35% (of par value) and a stock dividend of 5% (of par value) for 2018, with cash dividend amounting to KWD 214.3mn (Cash Payout of 58% of earnings) and stock dividend amounting to KWD 31.1mn. The bank has raised the dividend per share (DPS) to KWD 0.035 in FY18, from a consistent KWD 0.030 over the last few years. We expect DPS to remain stable at KWD 0.035 over the forecast period, as the bank pursues growth and maintains high capital adequacy at the same time through retained profits. However, in the terminal period, we have assumed a retention ratio of 50% for our base case scenario.

NBK: Dividend History



NBK: Dividend Yield



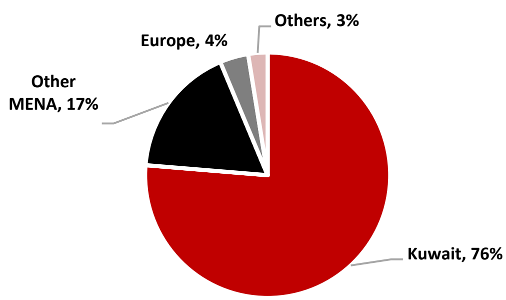
Source: Bank Financials, U Capital Research

Note: for FY19e, Dividend Yield assumes the current market price

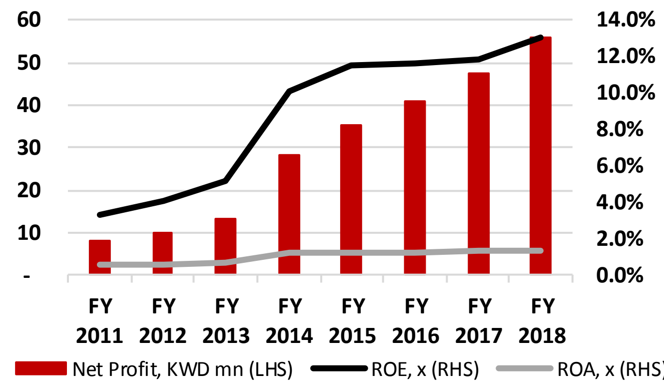
Geographic & Business diversification strategy is paying off well

NBK is currently present in 14 countries outside of Kuwait. NBK's international operations contributed KD112.7m to group profits in 2018, an increase of 19%YoY. In addition to geographic diversification, NBK remains unique amongst Kuwaiti Banks in being positioned to operate in both conventional banking and Islamic banking. The bank's Islamic banking subsidiary, Boubyan Bank, continues to perform extremely well, and delivered profits of KD56.2m in 2018, +17.9%YoY. Approximately 40% of the group's earnings were contributed by International and Islamic operations, which demonstrates a high degree of resilience and robustness through diversification of revenue stream.

Geographic Segments of Net Operating Income, FY18



Boubyan Bank: Key Profitability Indicators



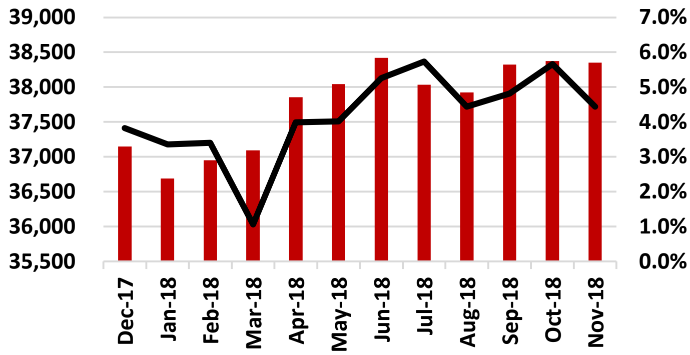
Source: Bank Financials, U Capital Research

Sector Overview & Outlook

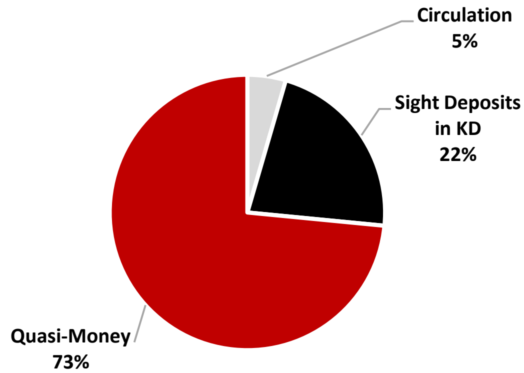
- **Broad money supply is healthy and growing**

Kuwait's money supply is growing at a healthy rate. M1, which comprises of currency in circulation and sight deposits, rose by 0.2%YoY at the end of Nov'18. M2, which comprises of M1 and Quasi-money, rose by 4.4%YoY.

Kuwait: Money Supply (M2)



Kuwait: Money Supply Components, Nov'18

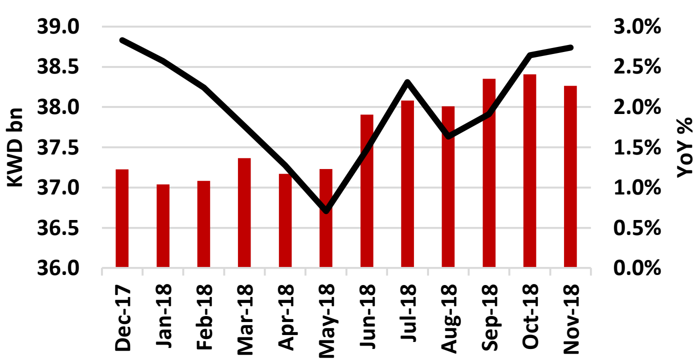


Source: CBK

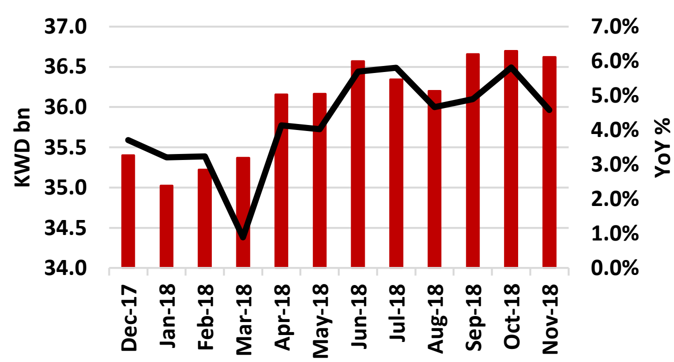
- **Credit Growth has picked up; Deposit growth is outpacing credit growth**

Local banks' private sector credit growth rose 2.7%YoY in Nov'18, with growth rate having picked up from 0.7%YoY in May'18. Private sector deposit growth has averaged at +4.3%YoY during the first 11 months of 2018. In Nov'18, deposits grew by 4.6%YoY to reach KWD 36.6bn.

Kuwait: Private Sector Credit



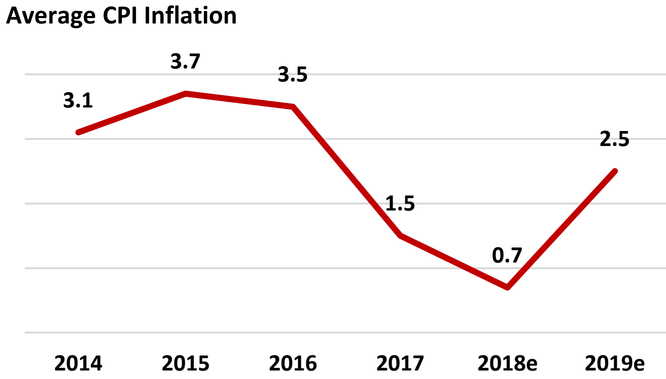
Kuwait: Private Sector Deposits

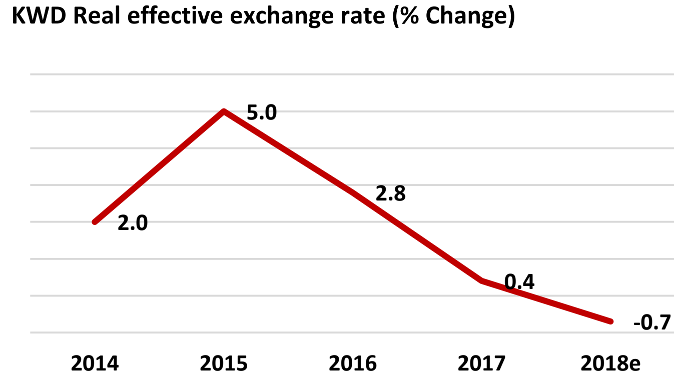


Source: CBK

- **Higher oil prices in 2017-18 boosted growth**

The IMF estimates that hydrocarbon output of Kuwait has risen by 1.2%YoY in 2018 following a contraction a year earlier. Buoyed by a confidence rebound and some fiscal loosening, non-oil growth has accelerated to 2.5%. Thanks to higher oil prices, the current account balance moved back into surplus in 2017 (almost 6% of GDP), which further rose to an estimated 13.2% in 2018. Inflation reached a multiyear low of 0.7% in 2018 due to weakness in housing rents, easing international food prices, and a strengthening KWD.





Source: IMF

Higher oil revenues and investment income helped improve the FY2017/18 overall balance to an estimated surplus of 8% of GDP. It is expected to reach almost 12% of GDP in FY18/19. However, fiscal financing needs—overall balance excluding investment income and compulsory transfers to the Future Generations Fund (FGF)—remained large at 12.5% of GDP in FY2017/18. Delays in the passage of a new debt law have rendered the government unable to issue debt since October 2017. As a result, it has had to draw on the General Reserve Fund (GRF) assets for financing, including to pay for maturing debt.

- **Oil GDP is expected to grow at 2.0% during 2019 and 2.5% in 2020**

The recent OPEC decision to cut production is expected to hold oil GDP growth to 2% in 2019[2], which could rebound to 2.5%[3] in 2020 given the spare capacity. The underlying fiscal position is projected to gradually improve over the medium term. The IMF assumes the introduction of excises on tobacco and sugary drinks in FY2020/21 and a value-added tax (VAT) in FY2021/22, small increases in fees for government services, and stricter enforcement of eligibility rules for transfers. As a result, the underlying fiscal position (non-oil fiscal balance excluding investment income) is projected to improve by 13.5% of non-oil GDP by FY2024/25. However, the overall fiscal balance will deteriorate by almost 8.5% of GDP over the same period, mainly reflecting the projected decline in oil revenues in 2019.

- **The country will require external financing, as per the IMF**

As per the IMF, Kuwait's fiscal balance excluding compulsory transfers to the Future Generation Fund (FGF) and investment income will average 13.5% of GDP deficit over the medium term. This will give rise to gross financing needs of USD 127bn over the next 6 years. The IMF's baseline scenario assumes that parliament will approve the new debt law, allowing borrowing to resume in FY2019/20. If the approval is delayed, the government will have to solely rely on the General Reserve Fund (GRF) for financing.

- **A sustained drop in oil prices and delays in reforms remain key risks**

Oil prices could decline if trade tensions were to heighten and global growth were to weaken. A sustained drop in oil prices would generate unfavorable macro-financial dynamics, with twin deficits, large financing needs, and tightening credit conditions with asset quality deterioration. Delays in fiscal and structural reforms could slow growth and increase fiscal deficits at a time when the global environment is becoming more challenging and financial conditions tightening. Should investors' appetite for exposure to Kuwait wane under these conditions, the government and banks could face higher funding costs and rollover risks. Should these risks materialize, Kuwait could draw on its large financial assets to meet its

[2] IMF

[3] IMF

fiscal financing needs while mitigating the impact on the financial sector and the real economy. Heightened security tensions and a challenging geopolitical environment in the region are an additional source of risk that could dampen confidence, investment and growth.

- **Foreign Holding in Kuwaiti Banks on the rise**

In December 2018, the Ministry of Commerce and Industry (MOCI) in Kuwait issued Decree No. 694/2018 to remove the Foreign Ownership Limits applied on listed bank equities. Additionally, foreign holding in Kuwaiti banks has been on the rise ever since the country was classified as an emerging market from a frontier market by FTSE in 2017 and a potential upgrade of the country by MSCI expected to materialize in 2019.

Important capital reforms that led to Kuwait's inclusion in FTSE Emerging Markets Index included the segmentation of stocks according to market capitalization and liquidity, intended to incentivize improvement. More recently, Kuwait started the publication of foreign ownership data for Kuwaiti banks for the first time. This was required by index providers to assess foreign ownership limits. Kuwait bourse started publishing such data in August 2018 and the following table illustrates the current foreign ownership in local banks.

Foreign Holding in Kuwaiti Banks

	Aug-18	Jan-19	Incremental Change in (pps)
Gulf Bank of Kuwait	1.46%	5.81%	4.35%
Warba Bank	0.94%	2.40%	1.46%
National Bank of Kuwait	***9.44%***	***10.69%***	***1.25%***
Kuwait Finance House	4.27%	5.43%	1.16%
Boubyan Bank	1.55%	2.52%	0.97%
Kuwait International Bank	6.33%	7.29%	0.96%
Ahli United Bank	0.28%	0.32%	0.04%
Al Ahli Bank of Kuwait	0.10%	0.10%	0.00%
Commercial Bank of Kuwait	0.23%	0.21%	-0.02%
Burgan Bank	3.17%	1.88%	-1.29%

Source: Kuwait Exchange

Currently, MSCI applies a FOL of 49% on the Foreign Inclusion Factors (FIF) for NBK. The new FIF for NBK will be announced coinciding with the February 2019 Quarterly Index Review, but MSCI announced that it will apply a Liquidity Adjustment Factor of 0.5 to the FIF of NBK as the Annual Traded Value Ratio (ATVR) of the security calculated based on the FIF after the removal of FOL does not meet the minimum ATVR requirement (i.e. minimum of 10% ATVR) for existing constituents.

Company Description

National Bank of Kuwait was established in 1952 as the first local bank and the first shareholding company in Kuwait and as the first indigenous bank in the GCC. It is the leading banking group in Kuwait in terms of assets, customer deposits and customer loans and advances. NBK is the dominant bank in Kuwait with more than 30% market share by assets.

The bank was established by a group of leading Kuwaiti merchants and it has retained the same core shareholder base since that time. Its shares are listed on the Kuwait Stock Exchange since 1984. The Bank's core businesses are (i) consumer and private banking, (ii) corporate banking, (iii) Islamic banking and (iv) investment banking and asset management. The Bank operates across 15 countries with a predominant focus on the MENA region.

Following its consolidation of Boubyan Bank in 2012, NBK became the only banking group in Kuwait to offer both conventional and Islamic banking services. This has allowed the Bank to leverage off the opportunities across both markets, particularly given the growing importance of Islamic Finance in Kuwait.

Associates	Country	Principal business	Ownership % 2018
Bank of London and the Middle East	UK	Banking	26
Turkish Bank A.S.	Turkey	Banking	34

Subsidiaries	Country	Sector	Ownership % 2018
Boubyan Bank K.S.C.P.	Kuwait	Islamic Banking	59.5
National Bank of Kuwait - Egypt S.A.E.	Egypt	Banking	98.5
Watani Investment Company K.S.C.(Closed)	Kuwait	Investment company	99.9
National Bank of Kuwait (International) plc	UK	Banking	100
NBK Banque Privée (Suisse) S.A.	Switzerland	Investment management	100
National Bank of Kuwait France SA	France	Banking	100
National Bank of Kuwait (Lebanon) S.A.L.	Lebanon	Banking	85.5
Credit Bank of Iraq S.A.	Iraq	Banking	84.3
National Investors Group Holdings Limited	Cayman Islands	Investment company	100
Watani Wealth Management Company	Saudi Arabia	Investment management	100
Watani Financial Brokerage Company K.S.C. (Closed)	Kuwait	Brokerage	93.3

Source: Company Financials, U Capital Research

Stable Credit Rating

Ratings Agency	Long Term Rating	Standalone Rating	Outlook
Moody's	Aa3	a3	Stable
S&P	A+	a-	Stable
Fitch	AA-	a-	Stable

Source: Company Website

Shareholding Pattern

The bank holds 89.2mn shares as Treasury Shares, which form 1.4% of the total issued shares, carried at 784fils per share. NBK's shares are listed on the Kuwait Stock Exchange since 1984 with only one shareholder holding owning more than 5% of the Bank's share capital (PIFSS (Public Institution for Social Security) owns 5.53% as of December 2017).

Key Financials

(KWD mn)	FY16	FY17	FY18	FY19e	FY20e	FY21e
Income Statement						
Interest/Financing Income	793	899	1,083	1,200	1,330	1,494
Interest Expense/Payment to Depositors	(224)	(270)	(393)	(451)	(536)	(629)
Net Interest/Financing Income	**570**	**629**	**690**	**749**	**794**	**865**
Fee & Commission Income	133	139	150	159	169	179
Other Income	43	55	43	45	48	51
Total Non-Interest/Financing Income	**176**	**194**	**193**	**204**	**216**	**230**
Total Operating Income	**745**	**823**	**883**	**953**	**1,010**	**1,094**
Provisions expense	(152)	(188)	(180)	(170)	(155)	(146)
Operating Expenses	(252)	(265)	(276)	(303)	(319)	(346)
Profit Before Taxation	**341**	**369**	**427**	**480**	**537**	**602**
Taxation & Minority Interest	(46)	(47)	(56)	(64)	(70)	(79)
Net Profit Attributable to Parent	**295**	**322**	**371**	**417**	**467**	**523**
Balance Sheet						
Cash Balances	2,687	2,744	2,967	3,434	3,519	3,892
Deposits with CBK, other banks & FIs	3,650	4,220	4,046	4,424	4,690	4,975
Gross Loans & Financings	14,280	15,118	16,009	16,953	17,969	19,064
Loan Loss Reserve	(668)	(616)	(506)	(536)	(568)	(602)
Net Loans & Financings	13,611	14,503	15,503	16,417	17,401	18,461
Other Assets	4,290	4,568	4,912	5,903	6,255	6,635
Total Assets	**24,239**	**26,035**	**27,428**	**30,179**	**31,865**	**33,964**
Deposits from Banks & FIs	7,348	7,469	8,090	8,951	9,432	10,036
Deposits from Customers	12,608	13,780	14,389	15,918	16,774	17,848
Other Borrowings	541	837	796	881	928	987
Other Liabilities	337	388	451	499	526	560
Paid-up Capital	564	592	621	652	685	719
Retained Earnings	1,163	1,252	1,315	1,474	1,670	1,908
Other Reserves	1,158	1,186	1,227	1,244	1,265	1,289
Shareholders' Equity	**2,885**	**3,029**	**3,163**	**3,370**	**3,620**	**3,916**
Minority Interest	309	321	327	349	375	405
Tier 1 Perpetual Notes	211	211	211	211	211	211
Total Equity & Liability	**24,239**	**26,035**	**27,428**	**30,179**	**31,865**	**33,964**
Cash Flow Statement						
Cash from operations	(384)	249	806	1,071	581	893
Cash from investing activities	329	248	352	453	325	350
Cash from financing	(82)	55	(232)	(152)	(170)	(170)
Net changes in cash	(794)	57	223	467	86	373
Cash at the end of period	2,687	2,744	2,967	3,434	3,519	3,892
Key Ratios						
Return on Average Assets	1.2%	1.3%	1.4%	1.4%	1.5%	1.6%
Return on Average Equity	10.5%	10.9%	12.0%	12.8%	13.4%	13.9%
Return on Tangible Average Common Equity (ROTCE)	13.4%	13.2%	14.4%	14.9%	15.6%	16.1%
Recurring Income/Operating Income	94.3%	93.3%	95.2%	95.3%	95.3%	95.4%
Yield on Interest Earning & Islamic Finance Assets	3.5%	3.7%	4.2%	4.4%	4.5%	4.7%
Cost of Funds	1.1%	1.3%	1.7%	1.8%	2.0%	2.2%
Net Spread	2.4%	2.5%	2.5%	2.5%	2.6%	2.6%
Net Interest Margin (NIM)	2.5%	2.6%	2.7%	2.7%	2.8%	2.8%
Cost to Income Ratio	33.8%	32.3%	31.3%	31.8%	31.5%	31.7%
Net Loans to Customer Deposits	108.0%	105.2%	107.7%	106.5%	107.1%	106.8%
NPLs to Gross Loans	1.3%	1.4%	1.4%	1.4%	1.4%	1.4%
NPL Coverage (x)	3.6	2.9	2.3	2.3	2.3	2.3
Cost of Risk (bps)	66.6	78.3	70.3	61.7	52.3	46.4
Equity to Total Assets	11.9%	11.6%	11.5%	11.2%	11.4%	11.5%
Cash Dividend Payout Ratio	56.3%	54.1%	57.8%	54.1%	50.7%	47.6%
Cash Dividend per share (KWD)	0.030	0.030	0.035	0.035	0.035	0.035
Stock Dividend per share (%)	5%	5%	5%	5%	5%	5%
Adjusted EPS (KWD)	0.053	0.055	0.061	0.065	0.069	0.074
Adjusted BVPS (KWD)	0.614	0.612	0.604	0.611	0.622	0.638
Tangible BVPS (KWD)	0.415	0.421	0.422	0.425	0.436	0.451
Market Price (KWD) *	0.674	0.590	0.834	0.886	0.886	0.886
Dividend Yield	4.4%	5.1%	4.2%	4.0%	4.0%	4.0%
P/E Ratio (x)	12.7	10.6	13.8	13.7	12.8	12.0
P/BV Ratio (x)	1.1	1.0	1.4	1.5	1.4	1.4
P/TangBVPS (x)	1.6	1.4	2.0	2.1	2.0	2.0

* Market price for 2019 and subsequent years as per latest closing price of 10/02/2019

Source: Company Financials, U Capital Research

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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