

Marmore First Take

KFH-AUB Merger

Towards creating the second largest
Islamic Bank in the world

October, 2017

Highlights

- KFH-AUB merger, if it materializes, will create the second largest Islamic bank in the world after Al-Rajhi Bank.
- Such high-profile mergers can provide scale to GCC banks in a global setting, a key missing point for GCC banks.
- Key risks to the merger would be regulatory roadblocks, governance & merger roadmap which will involve integration of conventional and Islamic business models

We have witnessed a series of high-profile mergers in the recent past in the Gulf's banking sector as low oil prices has squeezed deposits, pushed up bad loans and impacted profitability. Recently, First Abu Dhabi Bank (FAB) was created in the United Arab Emirates after a merger between two Abu Dhabi based lenders, First Gulf Bank (FGB) and National Bank of Abu Dhabi (NBAD). In KSA, news of merger of Saudi British Bank (SABB) and Alawwal popped up in April, 2017.

In Kuwait, the media broke out the news of possible merger between Kuwait Finance House (KFH) and Bahrain's Ahli United Bank (AUB) during May, 2017. Recently, it has been reported that KFH main shareholder, Kuwait Investment Authority (KIA) which owns 24% stake has appointed an adviser to evaluate the feasibility of the merger. This potentially points to the serious consideration of the deal.

KFH operations are primarily focussed in Kuwait and Turkey. It also has operations albeit smaller in Saudi Arabia, Malaysia and Bahrain. Ahli United Bank is Bahrain's largest lender and has a presence in Kuwait, Egypt, Iraq, Oman, Libya and the United Kingdom either directly or through affiliates. Dispersed asset base across geographies could present a challenge to integration. Further, KFH operates in accordance with

sharia law and is an Islamic bank while AUB operates as a conventional bank and also offers Islamic banking solutions.

However, credit rating agencies have opined that the merger would be credit positive for KFH as it would strengthen and diversify KFH's business; offer benefits from potential economies of scale, support profitability and widen scope for lending in a slowing economic environment.

Upon successful merger with USD 85bn in total assets, the merged entity would be the sixth-largest bank in GCC, world's second largest Islamic bank after Al Rajhi bank, and Kuwait's largest bank followed by NBK, which currently enjoys the status of being the largest bank in Kuwait¹. While GCC banks have a dominant position in the local stock markets, they lacked size when benchmarked globally. Such high profile mergers can fill the gap. Having said that, the expected merger is still a news in the making. Once it becomes a reality, the roadmap for merger should be keenly watched as more often than not a poor roadmap can make the merger process cumbersome, time consuming and expensive. A roadmap will involve several milestones including technology integration.

The deal being a merger of Islamic bank with conventional one could have regulatory roadblocks that could increase the risk of merger. Further, any merger of Kuwaiti banks would need to get prior approval from Central Bank of Kuwait (CBK) and Capital Market Authority (CMA). Recently, certain MPs have protested claiming that the merger deal lacks transparency and the objectives of the deal aren't clear. This would be the second such merger in the region wherein a conventional bank is being merged with an Islamic bank following the merger announcement of Qatari banks Masraf Al Rayan (Islamic bank), Barwa

Bank (Islamic bank) and International Bank of Qatar (conventional bank). In both the cases the merged entity would be operated as a shaiarh-compliant lender.

Government of Kuwait effectively owns c.44% of KFH (24% indirectly through KIA) and c.19% of AUB. Government of Bahrain is the other largest shareholder in AUB. Thus, we believe there would be only limited hindrance from regulatory authorities regarding the deal.

Key Metrics

2016 (USD mn)	KFH	AUB
Gross Loans	32,186	19,304
Total Assets	54,029	31,322
Total Deposits	34,956	24,982
Net Interest Income	1,440.3	828.2
Net Income	547.1	570.6
Gross Loan Growth (5yr CAGR, 2012-2016)	7.0%	3.8%
Total Deposit Growth (5yr CAGR, 2012-2016)	-1.8%	2.8%
Nonperforming Loans (% of Total Loans)	4.74%	3.42%
Tier 1 Risk-Adjusted Capital Ratio	16.25%	17.1%
Pre-tax ROA	1.4%	2.1%
Pre-tax ROE	12.4%	16.7%

Annexure

KFH Ownership

Shareholders	Ownership (as % of O/S)
Kuwait Investment Authority	24.08%
Government of Kuwait	23.97%

AUB Ownership

Shareholders	Ownership (as % of O/S)
Government of Kuwait	18.68%
Government of Bahrain	10.11%
Tamdeen Real Estate Co KPSC	8.17%
Al Sabah (Sheikh Salim Sabah Al Nasser)	5.38%
World Bank	5.09%

Source: Reuters

¹ Based on 2016 financials

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Economic Research

- SME Startup Stories in GCC
- Bitcoin to Blockchain
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- FIFA World Cup 2022: Qatar (2013)

Industry Research

- Private Equity: GCC
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- Contracting: Saudi, UAE, Kuwait
- Education: GCC, Saudi, UAE
- Investment Banking: GCC, UAE
- Healthcare: UAE, GCC, Saudi
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- Media: UAE Media, UAE Social Media, GCC Social Media, GCC Media
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Infrastructure Research

- Power: Kuwait, UAE, Qatar, Egypt, Saudi
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- Roads and Railways: Saudi, Qatar
- Real Estate: Qatar Residential Real Estate, Saudi Residential Real Estate, UAE Residential Real Estate, GCC Office Real Estate, Saudi Office Real Estate, GCC Affordable Housing, Kuwait Real Estate (Bilingual) (2015)

Policy Research

- An Innovation driven Economic Diversification Strategy for Kuwait (KFAS)
- Kuwait – Starting Business
- Kuwait Reforms (series): Education (2015)
- Oil & Gas Markets and the Emergence of New Resources (2014)
- GCC Countries & Asia: Bolstering Energy Ties (2014)
- GCC Energy Strategies: The Way Forward (2014)
- Blueprint for Public Sector Good Governance in Kuwait (2013)
- Kuwait: Private Labor Market (2013)
- Kuwait: Alternatives for Power Generation (2013)
- Kuwait: Sustainable Power Strategy (2012)
- Tools to Strengthen & Support Kuwait's Private Sector (2012)

Regulatory Research

- Kuwait's BOT law (2014)
- Land Reforms in Kuwait (2014)
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Company Reports

- KSA
 - Al Rajhi Bank
 - Almarai Group
 - Company for Cooperative Insurance (Tawuniya)
 - Jarir Marketing Co.
 - National Commercial Bank
 - Riyad Bank
 - SABIC
 - Samba Financial Group
 - Saudi Arabian Fertilizer Co.
 - Saudi Arabian Mining Company
 - Saudi British Bank
 - Saudi Cement Company
- Saudi Electricity Co
- Saudi Telecom
- Savola Group
- TASNEE National Industrialization Company
- The National Shipping Co. of Saudi Arabia (BAHRI)
- Qatar
 - Barwa Real Estate Co QSC
 - Commercial Bank of Qatar
 - Ooredoo
 - Qatar Electricity and Water Co
 - Qatar Insurance Co
 - Qatar National Bank




- UAE
 - Abu Dhabi Commercial Bank
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Periodic Reports

- Daily Morning Brief
- Daily Fixed Income
- Kuwait Daily
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