June 2014

Kuwait Credit Growth

Establishing a New Normal

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M.R. Raghu CFA, FRM
Head of Research
+965 2224 8280
RMandagolathur@markaz.com

N.C. Karthik Ramesh
Manager - Research
+965 2224 8000 Ext: 4611
KRamesh@markaz.com

Kuwait Financial Centre K.P.S.C. "Markaz"

P.O. Box 23444, Safat 13095, Kuwait
Tel: +965 2224 8000
Fax: +965 2242 5828
markaz.com

Executive Summary

Kuwait credit growth is expected to remain in the mid-to-high single digits due to an accomodative monetary policy, which has brought down the weighted average lending rate to 4.61% in September, 2013 from 5.08% a year earlier. According to IMF estimates, the credit growth for Kuwaiti banks is estimated at 8% for 2014, far lower than the historical average of 21.8% that prevailed during 2002-2008 (35% growth witnessed in 2007). The current credit growth rate can degenerate into a "new normal" unless there is a rapid change in economic and investment conditions providing Kuwaiti banks with more lending opportunities.

The banking loan book underwent a structural change in its product portfolio post the economic crisis. During the pre-crisis period, the Kuwait banking system was giving more preference to the corporates segment (67% of total loans in 2008) which includes Real Estate, Trade & Industry, Non-Banking Financial Institutions (NBFI) and others leading to a CAGR of around 25% between 2004 & 2008. Increasing non-performing loans, a strenuous period of restructuring and deleveraging led to a poor performance by the NBFI post the crisis. This coupled with a situation of oversupply in the real estate sector due to a lull in the business environment led to significant drop in loan growth rates in the corporate loans segment (at 1.4% CAGR between 2009 & 2013). This resulted in the share of corporate loan segment to fall to 61% in 2013.

Personal loans which comprises of installment loans, purchase of securities, consumer loans and others grew lower when compared to corporate loans, during the pre-crisis period, though at a healthy CAGR of 17% between 2004 & 2008. In line with the trend witnessed in the real estate sector in the corporate loans segment, the installment loans segment, which deals with the loans taken for property, grew at a CAGR of 18.5% between 2004 & 2008. Rise in the domestic stock market levels fuelled the demand for loans related to purchase of securities which grew at a rate of 32.5% between 2004 & 2008. Post crisis growth in personal loans segment moderated to a CAGR of 7.7% between 2009 and 2013. Lower interest rates, rise in salary levels and spending binge fuelled by growth of credit & debit cards led to a CAGR of 17% in consumer loans. The product portfolio started skewing in favor of the personal loans segment post the crisis leading to a share of 39% of total loans in 2013 (compared to 33% in 2008).

Key banking sector metrics such as NPLs, LLP & LDR have also witnessed a dramatic change post the crisis with stricter regulations coupled with banks' lower risk appetite. With falling NPLs & increasing LLP, the Kuwait banking system is poised to remain cautious in the foreseeable period.

Table 1: Credit Growth Snapshot

Country	2002-2008 avg.	2009-2013 avg.	2014f
Kuwait	21.8%	4.2%	8%
Saudi Arabia	22.1%	8.8%	15.3%
UAE	30.7%	3.3%	8.4%
Qatar	31.9%	19.5%	14.7%

Source: IMF, Markaz Research

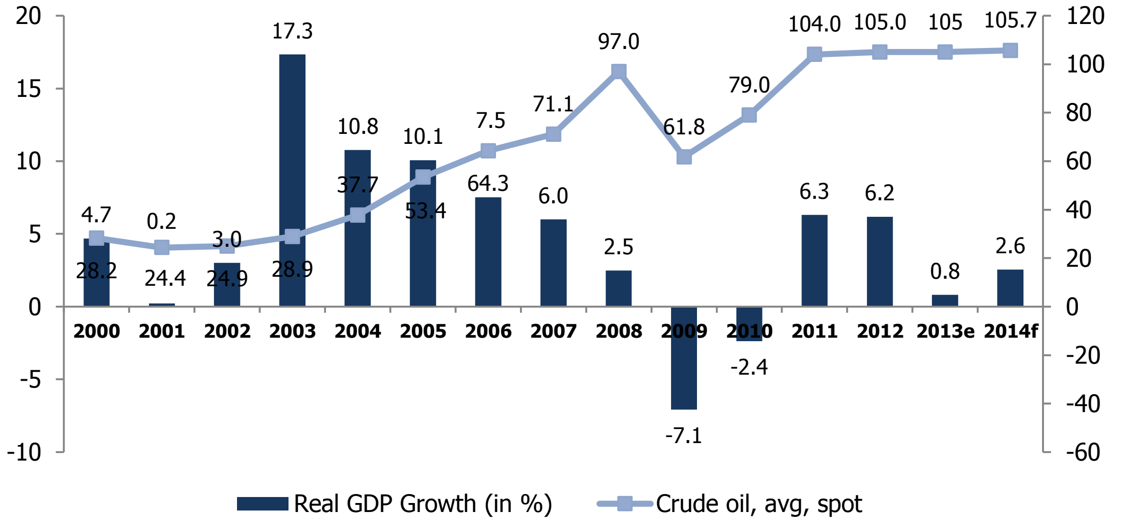
Credit growth – An historical analysis pre and post financial crisis

Kuwaiti banks suffered due to liquidity pressure, asset quality deterioration, higher losses on account of loan loss provisions and impariments.

The Global Financial Crisis (GFC) sent the banking sector across the globe into a spin and caused some of the largest banks and investment banks to shut operations. In conformity to global trends, the GFC was a watershed moment for the Kuwait Banking sector as well. The Kuwaiti banks suffered due to liquidity pressure, asset quality deterioration, higher losses on account of loan loss provisions and impariments. GDP growth in the region also took a hit due to lower oil prices and weak demand which further accentuated the problems.

Increasing demand for oil from across the globe and the government's decision on investments into non-hydrocarbon sectors fuelled growth across industries during the pre-crisis period. Althought the country is still witnessing positive GDP growth rates, the rates have significantly fallen from pre-crisis times. IIF estimates the GDP to grow by the low single digits over the next couple of years.

Figure 1: Kuwait Real GDP Growth Rates

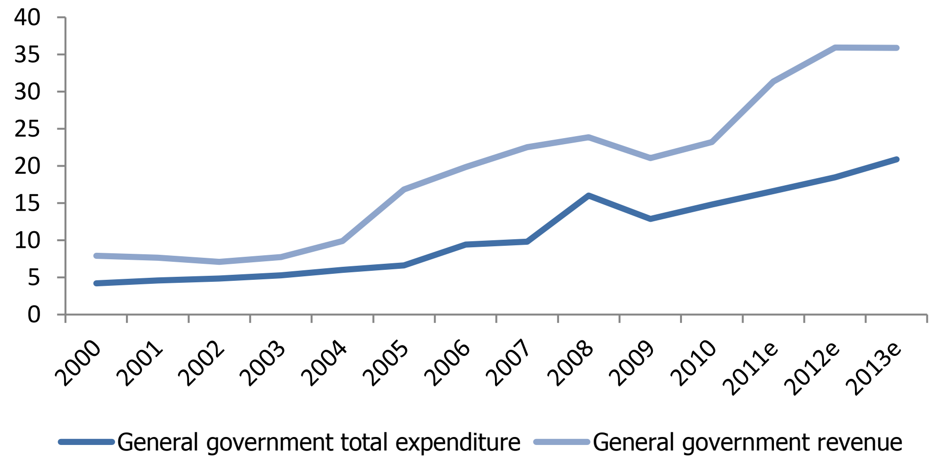


Source: IMF

IIF estimates Kuwait Real GDP growth rate to be in the low single digits over the next couple of years.

The economic boom witnessed in the first eight years of the decade from 2000 led to surge in oil prices which helped oil rich nations to generate more revenues and increase wealth. This led to a surge in government expenditure on infrastrucutre projects and thus leading to an overall development of the economy.

Figure 2: Kuwait Government Revenue & Expenditure

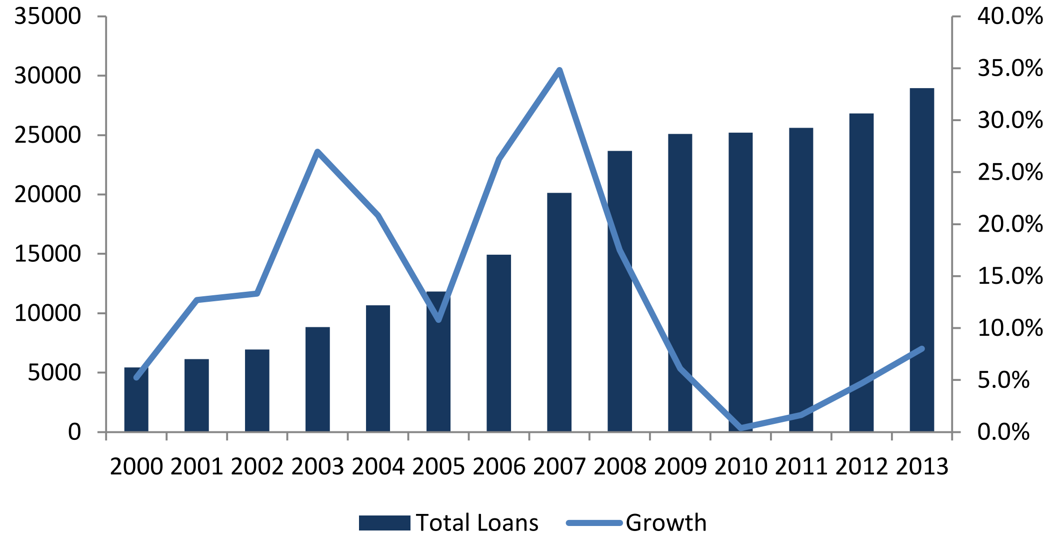


Source: IMF

Kuwait credit growth reached a historic high of 35% during 2008 and had a CAGR of 22% between 2004 and 2008.

Kuwaiti banks saw this as an opportunity and started increasing their exposure across both corporate and consumer segments. The credit growth reached historic highs at 35% during 2008 and had a CAGR of 22% between 2004 and 2008. Post the crisis, the impact was felt acutely on credit growth. Banks became stricter and more cautious in their approach and took safer bets to ensure capital protection. The credit growth reached a decade low of 0.4% in 2010 and had a CAGR of a meagre 3.6% betweeen 2009 and 2013.

Figure 3: Total Loans & Loan Growth



Source: CBK, Markaz Research

Rising consumer loans can be attributed to the increase in the salaries of the public sector employees.

Trends for credit growth have been positive in recent times with the total credit growing at 5% and 8% in 2012 & 2013 respectively. The corporate loans segments is just starting to show signs of recovery with growth rates of 0.6% & 5.5% in 2012 and 2013 respectively. This can be attributed to banks' conservative lending policies, the restructuring of corporate debt along with delay in implementing infrastructure and economic projects. Credit to investment companies has seen the worst falls over the last two years with -22% and -13.2% in 2012 & 2013 respectively. Loans to real estate & construction sector has seen a smart recovery with growths of 4.6% & 7.8% in 2012 and 2013 respectively.

However, the personal loans segment has shown a smart recovery over the last couple of years with growths of 12.3% and 12.2% in 2012 and 2013 respectively. Installment loans have grown by 17.5% and 16.5% and consumer loans have grown by 25.9% and 11.8% in 2012 and 2013 respectively. This can be attributed to the increase in the salaries of the public sector and the strengthening of purchasing power of Kuwaiti nationals.

Although the recent trends have shown a reversal with respect to credit growth, there is still a long way to go for banks to witness double digit growths, especially in the corporate segment. Although recent regulations of increasing the LDR to a range of 75% to 100% would help the sector, the optimism of banks towards various sectors such as Investment Companies and loans for purchase of securities is nowhere near pre-crisis levels. Improvements in housing projects and government expenditure on infrastructure projects is bound to improve the domestic economy and further boost credit growth.

Type of Loans – Personal vs. Corporate

Historically, Kuwaiti banks have lent more to the corporates when compared to the consumers.

Personal loans are defined as a loan granted by local banks to the customer with the purpose of financing purchase of his personal needs in terms of consumable and durable commodities, or for covering expenses of education or medication. It also includes installment loans which are utilized by the customer for non-commercial purposes, particulary for restoring or purchasing private residence.

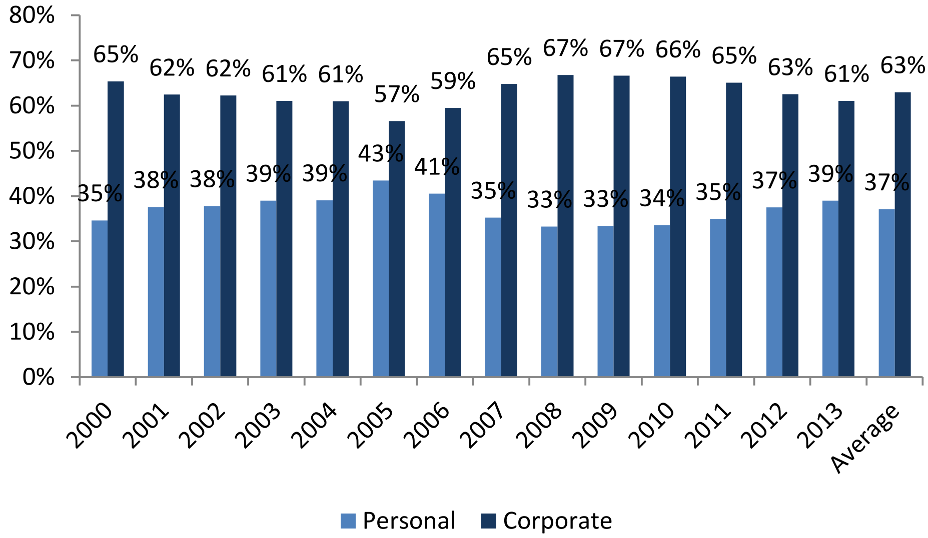
Corporate Loans are those that are given to the various domestic industries. Following is the break-up of Corporate Loans as defined by CBK:

- Trade
- Industry
- Construction
- Agriculture & Fishing
- Non-Banking Financial Institutions (NBFI)
- Real Estate
- Oil & Gas
- Others

Historically, Kuwiati banks have lent more to the corporates when compared to the consumers. From 2000 till 2013, corporate loans, on an average, form 63% of the total loans with the remaining lent to consumers.

Corporate loans witnessed a 25% CAGR before the crisis, between 2004 and 2008.

Figure 4: Personal vs. Corporate as % of Private Loans



Source: CBK, Markaz Research

Corporate Loans

Corporate loans witnessed phenomenal growth before the crisis with the CAGR between 2004 and 2008 at 25%. Banks significantly increased their exposure to the Real Estate & Construction companies (CAGR 2004-2008 at 30.7%) before the crisis since this sector was booming at those times with increase in demand for both residential and office space. Trade & Industry (CAGR 2004-2008 at 10.3%) also witnessed growth rates of over 20% during the pre crisis period which was the result of a high GDP growth rates witnessed across the region and the government's stance on diversifying into non-hydrocarbon industries.

This dropped significantly post the crisis with the CAGR between 2009 and 2013 at a meager 1.4%. Growth in loans provided to Real Estate & Construction (CAGR 2009-2013 at 3.4%) crashed to low single digits. The economic crisis brought with it a lull in the business environment which led to a significant drop in demand for real estate. This led to a situation of over supply in the region which subsequently led to the underperformance of the sector on the whole. The same phenomenon was witnessed across all types.

Table 2: Corporate Loans Growth Rates

Year	Trade & Industry (Avg. Share: 29%)	Real Estate & Construction (Avg. Share: 46%)	NBFI (Avg. Share: 14%)	Others (Avg. Share: 11%)	Total Corporate Loans
2000	-7.4%	-6.4%	8.7%	30.6%	-0.4%
2001	-0.1%	19.2%	99.6%	-42.3%	7.6%
2002	20.7%	15.2%	-12.1%	18.1%	13.0%
2003	21.1%	17.9%	20.8%	66.6%	24.5%
2004	31.3%	26.8%	20.1%	-23.2%	20.7%
2005	-27.4%	26.2%	19.4%	6.5%	2.8%
2006	25.7%	31.7%	53.0%	28.9%	32.8%
2007	28.6%	46.2%	68.8%	64.9%	46.9%
2008	26.2%	20.0%	14.7%	27.1%	21.1%
2009	0.3%	8.9%	5.1%	5.3%	5.8%
2010	4.1%	-1.2%	-2.3%	1.9%	0.1%
2011	3.6%	2.7%	-16.1%	0.9%	-0.5%
2012	4.6%	4.6%	-22.0%	2.8%	0.6%
2013	6.5%	7.8%	-13.2%	10.9%	5.5%
CAGR 2004-2008	**10.3%**	**30.7%**	**37.1%**	**30.2%**	**24.8%**
CAGR 2009-2013	**4.7%**	**3.4%**	**-13.7%**	**4.0%**	**1.4%**

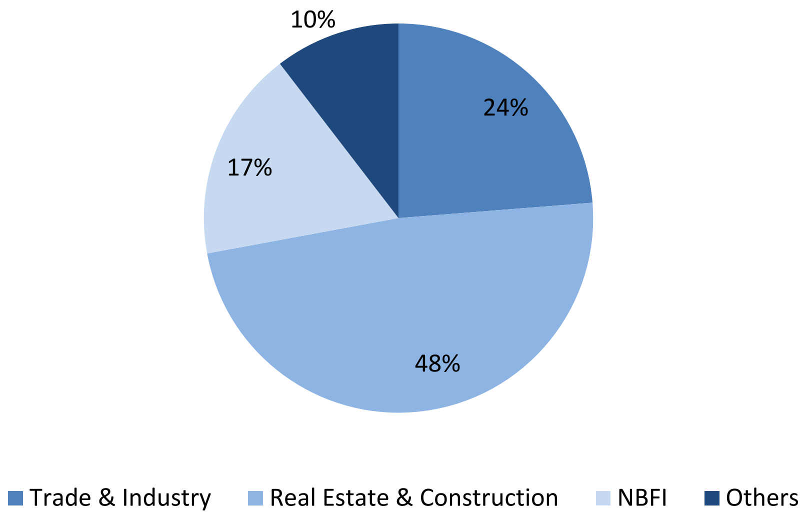
Source: CBK, Markaz Research

Banks still continue to hold a significant exposure to Real Estate & Construction but the growth of loans has faltered.

During 2008, the proportion of loans given to the Real Estate & Construction industry stood at 48% since the banks started increasing their exposure to the sector. This have since increased to 54% by the end of 2013 due to the reduced exposure to NBFIs. Banks still continue to hold a significant exposure to Real Estate & Construction but the growth of loans meted out to them has fallen drastically since 2008.

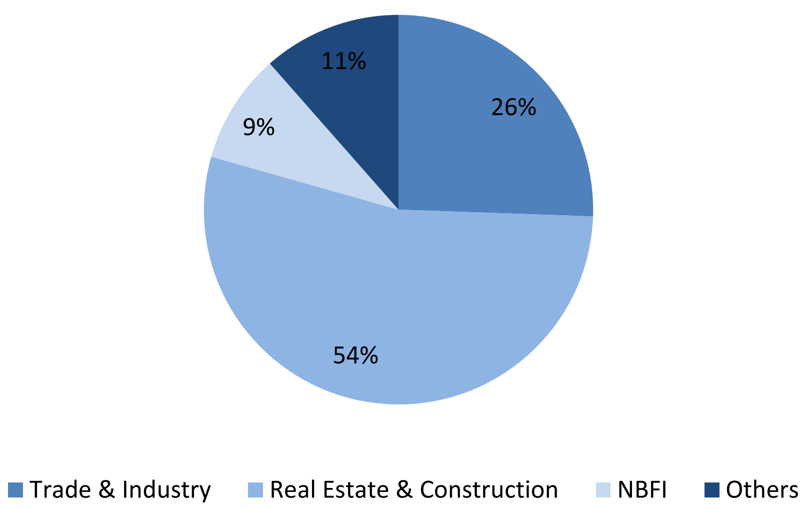
Installment loans segment, which deals with the loans taken for property, grew at a CAGR of 18.5% between 2004 & 2008.

Figure 5: Corporate Loans break up - 2008



Source: CBK

Figure 6: Corporate Loans break up - 2013



Source: CBK, Markaz Research

Phenomenal growth in domestic stock markets fuelled demand for loans related to purchase of securities which grew at a rate of 32.5% between 2004 & 2008.

Personal Loans

Personal loans grew lower when compared to corporate loans during the pre-crisis period although grew at a healthy CAGR of 17% between 2004 & 2008. In line with the trend witnessed in the real estate and construction sectors in the corporate loans segment, the installment loans segment, which deals with the loans taken for property, grew at a CAGR of 18.5% between 2004 & 2008. This was due to the fact that oil revenues led to higher per capita income for Kuwaitis who started buying/renovating property. The pre-crisis period also witnessed phenomenal growth in the domestic stock markets. This fuelled the demand for loans related to purchase of securities which grew at a rate of 32.5% between 2004 & 2008.

Post the crisis, the personal loans segment grew at a CAGR of 7.7% between 2009 and 2013 which is a far better performance in comparison to the corporate loans segment. This was fuelled by the continuing demand for installment loans (CAGR 2009-2013 at 11.4%) since the personal disposable incomes of Kuwaitis continued to

Post crisis the value traded fell by 43% in 2009.

rise even after the crisis due to higher oil prices. This is also due to the fact that Kuwaitis were looking at upgrading their living conditions. Post crisis saw a steep fall in the performance of the stock market with the value traded falling by 43% in 2009. The year on year value traded continued to fall by 42% and 50% respectively during 2010 and 2011. This coincided a steep fall in demand for loans related to purchase of securities (CAGR 2009-2013 at -0.9%).

Table 3: Personal Loans Growth Rates

Year	Consumer (Avg. Share: 17%)	Installment (Avg. Share: 49%)	Purchase of Securities (Avg. Share: 24%)	Other (Avg. Share: 10%)	Total Consumer Loans
2000	3.9%	NA	14.3%	-61.0%	17.8%
2001	11.6%	42.2%	55.2%	-29.5%	22.3%
2002	10.2%	32.1%	3.2%	-41.7%	13.9%
2003	7.3%	11.5%	89.6%	182.9%	31.0%
2004	-1.7%	33.1%	20.2%	18.5%	21.1%
2005	7.1%	18.0%	37.6%	44.8%	23.2%
2006	-4.2%	28.9%	28.5%	-17.6%	17.8%
2007	-16.5%	23.4%	34.4%	-23.2%	17.2%
2008	-2.3%	5.0%	29.6%	-10.8%	10.9%
2009	2.1%	11.7%	1.2%	-1.2%	6.6%
2010	10.3%	5.2%	-4.5%	-28.9%	0.8%
2011	18.5%	6.9%	-2.1%	33.8%	5.8%
2012	25.9%	17.5%	2.2%	-19.5%	12.3%
2013	11.8%	16.5%	1.1%	29.5%	12.2%
CAGR 2004-2008	**-4.3%**	**18.5%**	**32.5%**	**-4.9%**	**17.2%**
CAGR 2009-2013	**16.5%**	**11.4%**	**-0.9%**	**-0.2%**	**7.7%**

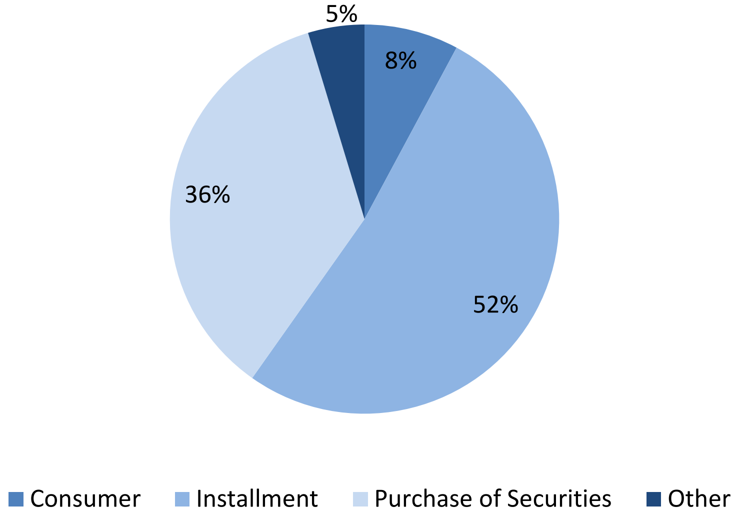
Source: CBK, Markaz Research

Consumer loans registered a phenomenal annual growth rate of 16.5% post the global financial crisis against -4.3% witnessed during the pre-crisis preiod.

During 2008, the proportion of loans given for the purpose of installments stood at 52% of total consumer loans and that of purchase of securities stood at 36%. Increase in demand for housing and strong market performance is seen as the reason behind the same. This however changed after the crisis with the proportion for installments at 62% and for purchase of securities at 24%. Consumer loans registered a phenomenal annual growth rate of 16.5% post the global financial crisis (from 2009 to the present), against -4.3% witnessed during the pre-crisis preiod (2004 to 2008). This could be attributed to the lower interest rates prevailing post crisis along with healthy rise witnessed in public sector salary levels. Spending binge fueled by growth of credit and debit cards and getting stuck in debt cycle in the hope that debt waiver would kick in at some point of time could also be a reason.

Non Performing Loans as a % of Total Loans in Kuwait averaged at 4.8% between the period 2005 till 2008.

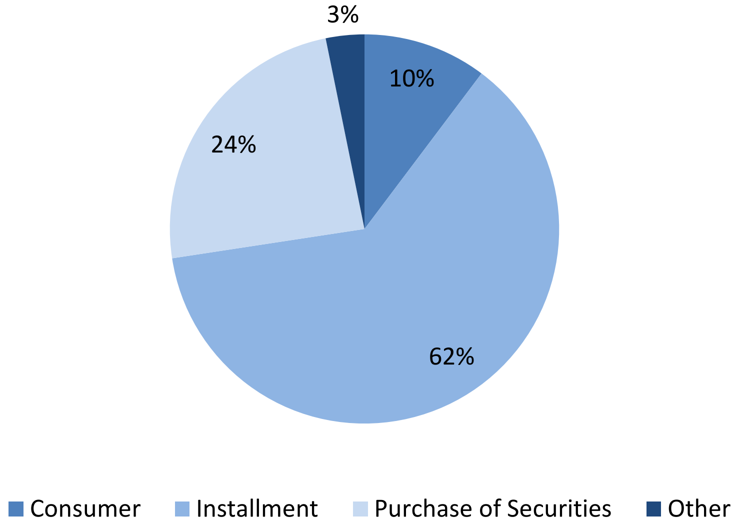
Figure 7: Personal Loans break up - 2008



Source: CBK

Non-performing loans accelerated to 11.5% in 2009.

Figure 8: Personal Loans break up – 2013



Source: CBK, Markaz Research

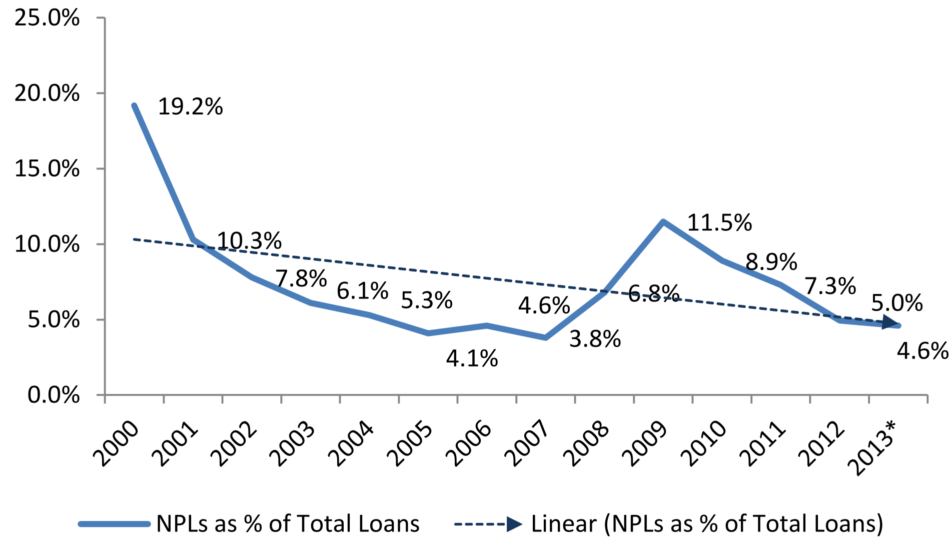
Non-Performing Loans (NPL)

Non Performing Loans are defined as those loans where the debtor has not made the scheduled payments for at least 90 days. A nonperforming loan is either in default or close to being in default.

Non Performing Loans as a % of Total Loans in Kuwait averaged at 4.8% between the period 2005 till 2008. The banking industry already started feeling the impact of the crisis by the end of 2008 where the the ratio grew to 6.8%. This accelerated to 11.5% in 2009 before coming down to the levels of pre-crisis levels at 4.6% in 2013. The average rate for NPL between 2009 and 2013 was 7.5%. Much of the fall can be attributed to the strict regulations enforced by the CBK.

The ratio of loan loss provisons as a percentage of total loans took a huge leap from 0.5% in 2007 to 3.2% in 2008.

Figure 9: Non Performing Loans as % of Total Loans



Source: IMF, CBK. *as on June 2013

Loan Loss Provisions as % of Total Loans

Loan loss provisions can be defined as an expense set aside as an allowance for bad loans. To analyze the loan loss provisions made by Kuwait banks, we took the loan loss provisions data of top 9 local banks listed in Kuwait. In line with the trends witnessed in NPLs, the banks started setting aside higher provisions for loan losses in response to increasing NPL's. The ratio of loan loss provisons as a percentage of total loans took a huge leap from 0.5% in 2007 to 3.2% in 2008. Since then, it has fallen to levels of 2% in 2013. The average rate during the period 2004 to 2008 was 1.3% as compared to the average from 2009 to 2013 of 2.2%.

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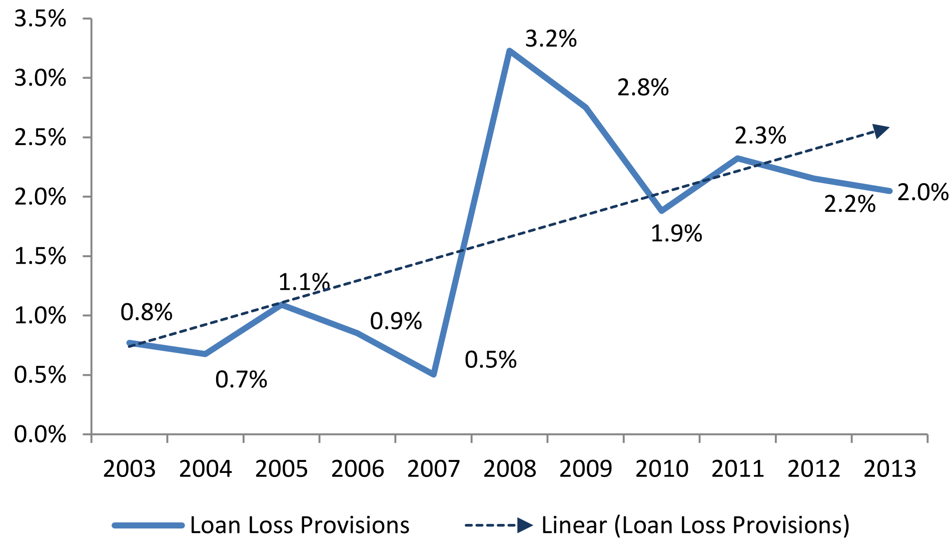
Figure 10: Loan Loss Provisions as % of Total Loans



Source: Reuters, Markaz Research

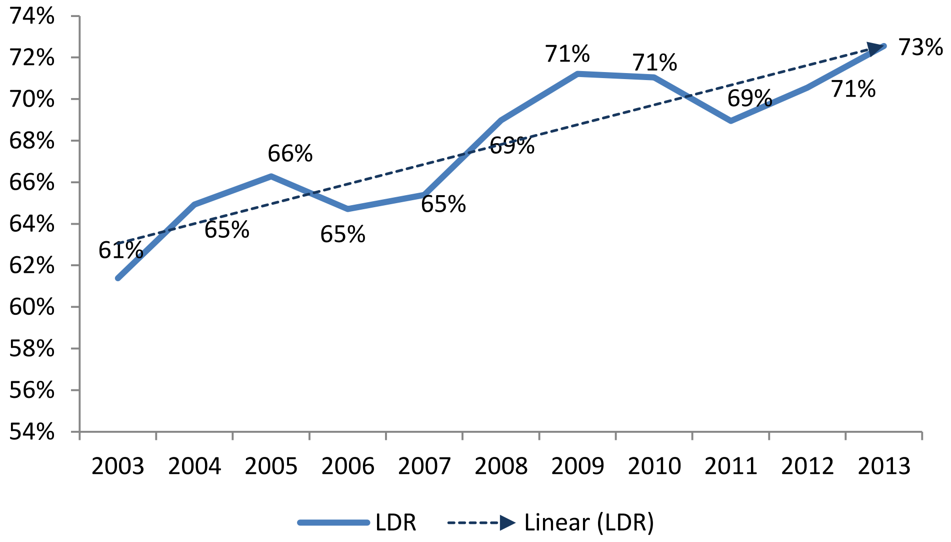
Loan to Deposit Ratio (LDR)

During the pre-crisis times, the LDR increased from 61% in 2003 to 69% in 2008 indicating an optimistic view of the banks.

Loans to Deposit Ratio is arrived at by dividing the banks' total loans by its total deposits. To analyze the ratio for Kuwait banks, we took the deposits and loans data of top 9 local banks listed in Kuwait. During the pre-crisis times, the ratio increased from 61% in 2003 to 69% in 2008 indicating an optimistic view of the banks. The ratio increased in 2009 to a level of 71% (due to a marginal increase in loans and decrease in deposits) and after witnessing a brief fall in 2011, it has peaked at 73% in 2013. The CAGR for deposits between 2004 and 2008 was 28.3% which has drastically reduced to 7.9% between 2009 and 2013. This was mirrored by the growth in Loans as the CAGR witnessed between 2004 and 2008 was 26.4% which fell to 7.4% between 2009 and 2013. Deposits rates have however shown an optimistic trend by growing at 11.3% and 6.4% in 2012 and 2013 respectively while loans have grown by 13.9% and 9.5% respectively in the same periods.

The CAGR for deposits between 2004 and 2008 was 28.3% which has drastically reduced to 7.9% between 2009 and 2013.

Figure 11: LDR for Kuwait Banks



Source: Reuters, Markaz Research

Causes for Structural Changes in Credit Growth

Corporate Loans

NBFI Sector

NBFI's share in the corporate loans averaged 16%, while post crisis (2009-13), the share fell to 14% with 2013's share being 9%.

Corporate loans has witnessed a major structural change in the form of the fall in loans provided to the NBFI sectors. Prior to the crisis, NBFI's share in the corporate loans averaged 16%, while post crisis (2009-13), the share fell to 14% with 2013's share being 9%. This is mainly due to increasing non-performing loans in this segment shadowed by the poor performance of the investment sector. The investment sector has gone through a strenuous period of restructuring and deleveraging ever since the global financial crisis erupted in 2008. This led to the drop in CAGR of credit to the sector from 37.1% during 2004-2008 to -13.7% during 2009-2013.

Table 4: Kuwait Investment Sector Performance

KD billion	2007	2008	2009	2010	2011	2012	CAGR %
Total Assets under management	18.81	15.38	14.72	15.85	12.93	12.49	-7.90%
Total Assets	16.25	18.01	16.16	15.55	14.96	14.67	-2.00%
Total Equity	6.43	4.99	4.35	3.93	3.79	3.44	-11.70%
Net Income	1.748	-0.882	-0.771	-0.345	-0.204	-0.044	nm

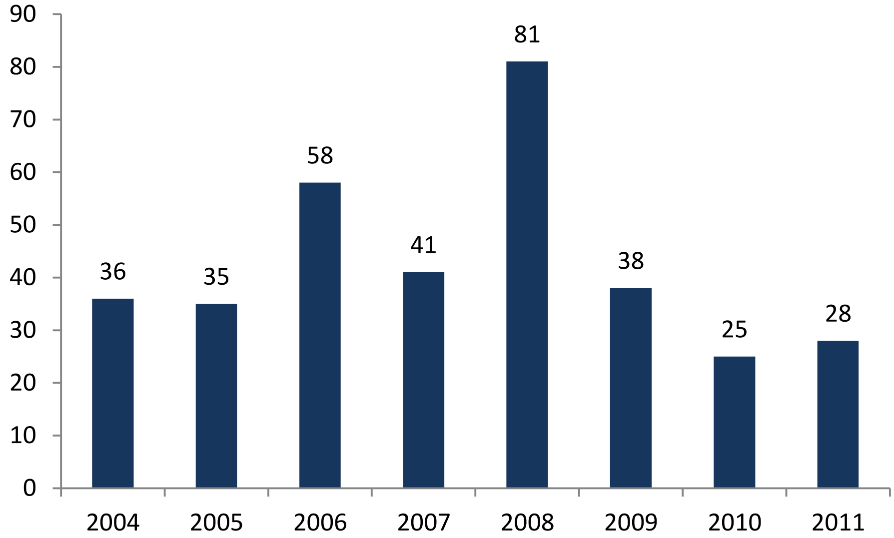
Source: Reuters, Markaz Research

Real Estate & Construction Sector

Though banks still continue to hold a significant exposure to real estate & construction sector the growth rate of loans has fallen drastically since 2008.

Although the Real Estate & Construction sector has managed to dominate the corporate loans segment, the real estate sector, especially the office real estate segment, continues to suffer due to a situation of oversupply. Majority of demand is driven by the tenants who are looking to upgrade office space from lower grade to higher grade office space. Oversupply in the market and higher vacancy rates diminished the prospects of recovery in the office real estate market. Average office rents have declined by more than 50 percent from the peak levels of 2009 due to weak demand. This has led to the drop in CAGR of credit to the sector from 30.7% during 2004-2008 to 3.4% during 2009-2013. During 2008, proportion of loans given to the real estate & construction industry stood at 48% which has increased to 54% in 2013. This is due to the reduced exposure in NBFIs. Though banks still continue to hold a significant exposure to real estate & construction sector the growth rate of loans has fallen drastically since 2008.

Figure 12: Historical demand for office space in Kuwait ('000)



Source: DTZ, Markaz Research

The KWSE Price Index which gave an average return of 17.4% from 2004 to 2008 gave a return of -0.6% from 2009 to 2013.

Personal Loans

Purchase of Securities Segment

Under this segment, consumers take on debt to purchase securities in the market. The economic crisis impacted equity markets around the world and Kuwait market was no exception. The KWSE Price Index which gave an average return of 17.4% from 2004 to 2008 gave a return of -0.6% from 2009 to 2013. Value traded plummetted and the confidence from a retail perspective is yet to be regained. This led to the drop in CAGR of credit to the segment from 32.5% in 2004-2008 to --0.9% in 2009-2013. Prior to crisis, purchase of securities segment accounted for 36% (2008) of personal loans while in 2013 purchase of securities segment dropped to 24% of the total personal loans availed.

Prior to crisis, purchase of securities segment accounted for 36% of personal loans.

Table 5: Kuwait Value Traded

Year	Value Traded (USD Mn), Kuwait
2000	4,461
2001	12,385
2002	23,102
2003	56,199
2004	52,824
2005	98,288
2006	63,946
2007	129,588
2008	132,506
2009	75,275
2010	43,743
2011	21,767
2012	26,118
2013	37,608

Source: Reuters, Markaz Research

High demand in residential rental properties is due to the growing housing needs of expatriates who cannot own a property in Kuwait and depend on rental housing.

Installment Loans

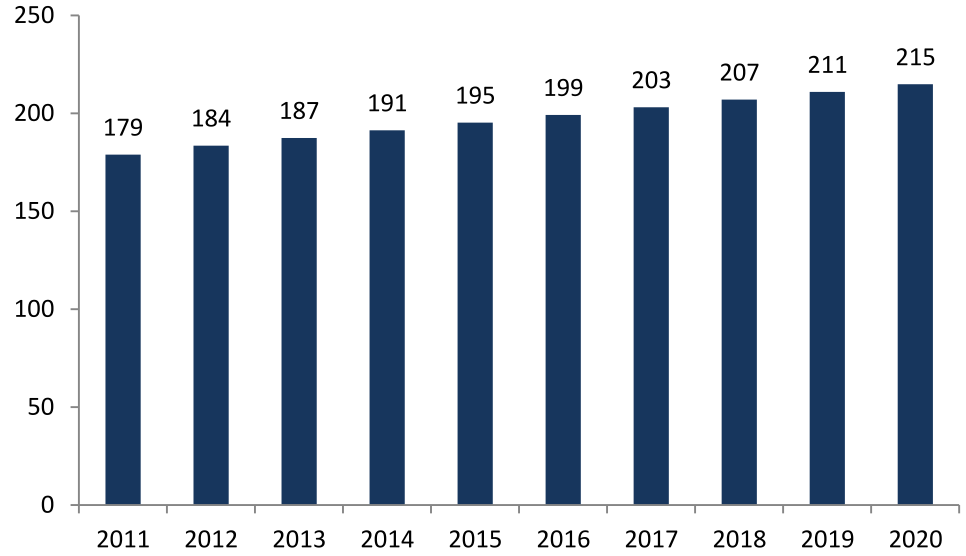
Installment loans deals with the credit given to the kuwaiti residents to restore or purchase private residence. Kuwait has witnessed high demand for residential units driven by the growing population. But, low supply of housing units has led to sluggish growth in the residential real estate market. Restrictive legislations passed by the Kuwait government, in 2008, to control the speculation further worsened the supply of residential units. However, Government has taken some initiatives to combat the supply shortage in residential market such as creation of three new cities, partnering with private developers in construction of housing units and increase in house financing loans.

High demand in residential rental properties is due to the growth of expatriates in country. As expatriates cannot own a property in Kuwait, there has been a surge in demand for investment properties over the last decade. Total housing demand is expected to reach 880,000 units in 2020 as per Markaz estimates. A total of 423 thousand units are required to meet the growing demand in Kuwait over 2010-20.

This led to good performance by this segment with respect to credit growth. Although the CAGR for credit growth dropped from 18.5% (2004-2008) to 11.4% (2009-2013), it has still shown positive double digit growth which is a good sign. Its share of total consumer loans has also gained from 52% in 2008 to 62% in 2013.

Installment loan share of total consumer loans has gained from 52% in 2008 to 63% in 2013.

Figure 13: Annual housing demand estimates for Kuwait ('000)



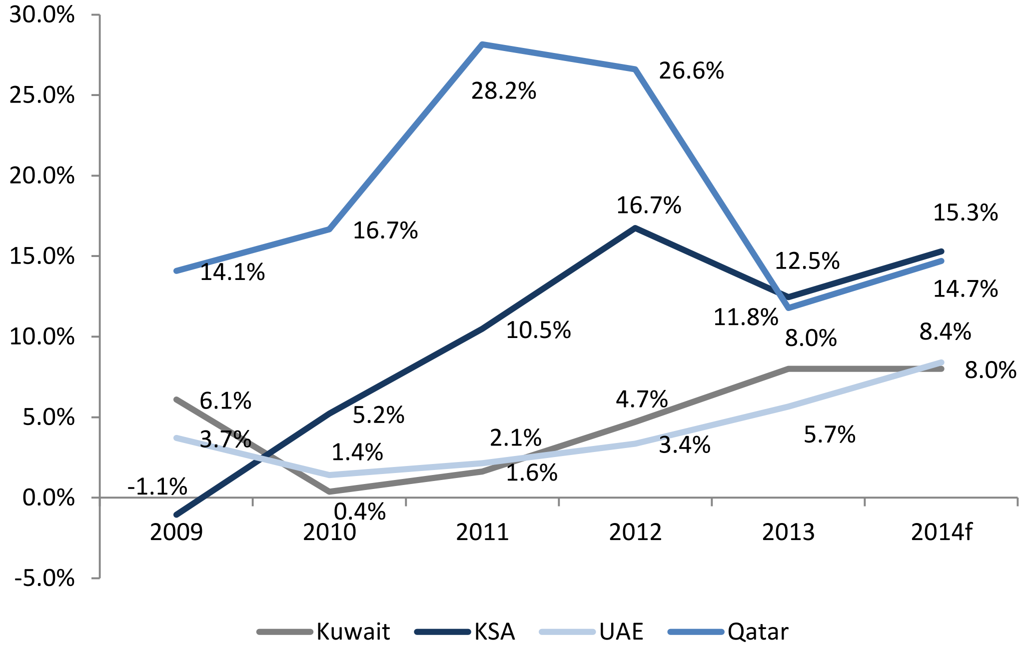
Source: Markaz Estimates, The Public Authority for Civil Information

Estimating Future Credit Growth

Kuwait credit growth is expected to remain elevated due to accomodative monetary policy.

IMF has provided forecasted credit growths for the GCC countries for 2014. While Kuwait credit growth is expected to remain in mid-to-high single digits due to accomodative monetary policy, which has brought down the weighted average lending rate to 4.61% in September, 2013 from 5.08% a year earlier; IMF expects credit growth in Qatar to rise to 14.7% (2014f) from 16.2% (2013) which certainly looks on the higher side since currently Qatar imposed sectorial credit exposure limits, increased reserve requirements, liqudity ratio and decreased loan-to-value ratio. Declining NPLs, end of provisioning requirements cycle and ample liquidity in the system is expected to prop up credit growth in UAE to 8.4%. Although rising inflation in Saudi Arabia, higher labor costs as a result of implementing 'Nitaqat' scheme could test credit growth in the coming year, IMF expects its credit to grow at 15.3%.

Figure 14: Forecasted Loan Growth



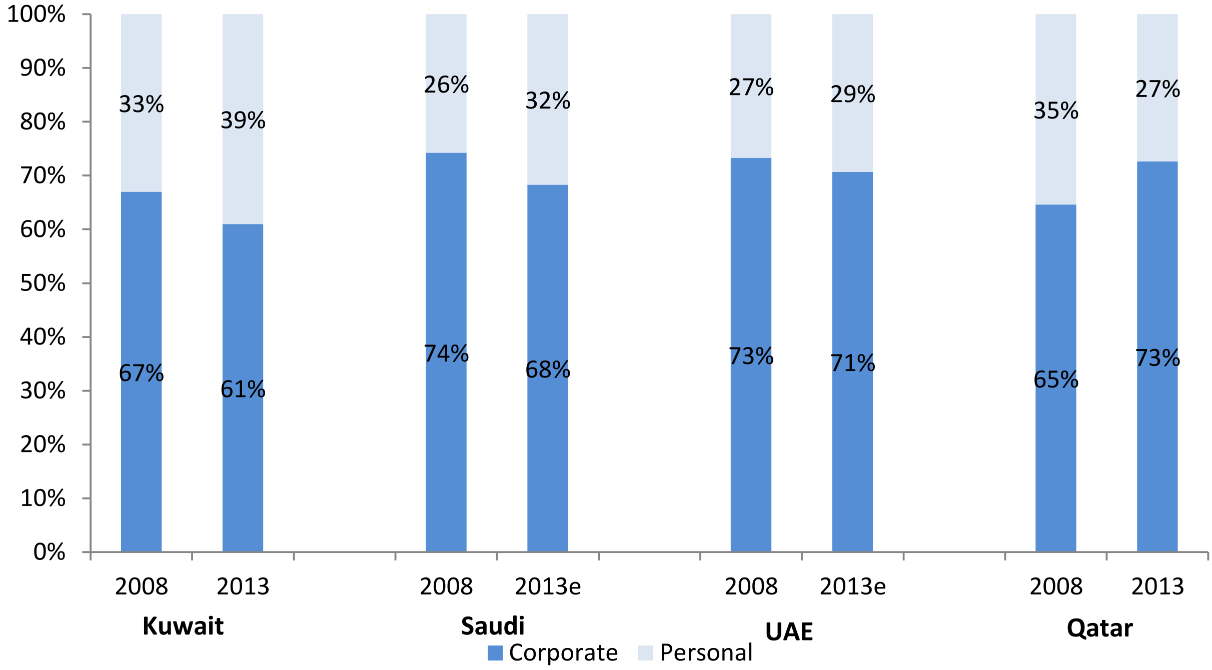
Source: Respective Central Banks, Markaz Research
Note: Growth rate as on 2013 for UAE is estimated

Share of personal loans has been steadily increasing signifying the consumer confidence levels in the economic outlook.

GCC Comparison

Personal loan component as a share of private credit which peaked in the year 2005 hit trough during the financial crisis. Though still below from the pre-crisis level, the share of personal loans has been steadily increasing signifying the consumer confidence levels in the economic outlook.

Figure 15: GCC Overall Credit Scenario



Source: Respective Central Banks, Markaz Research

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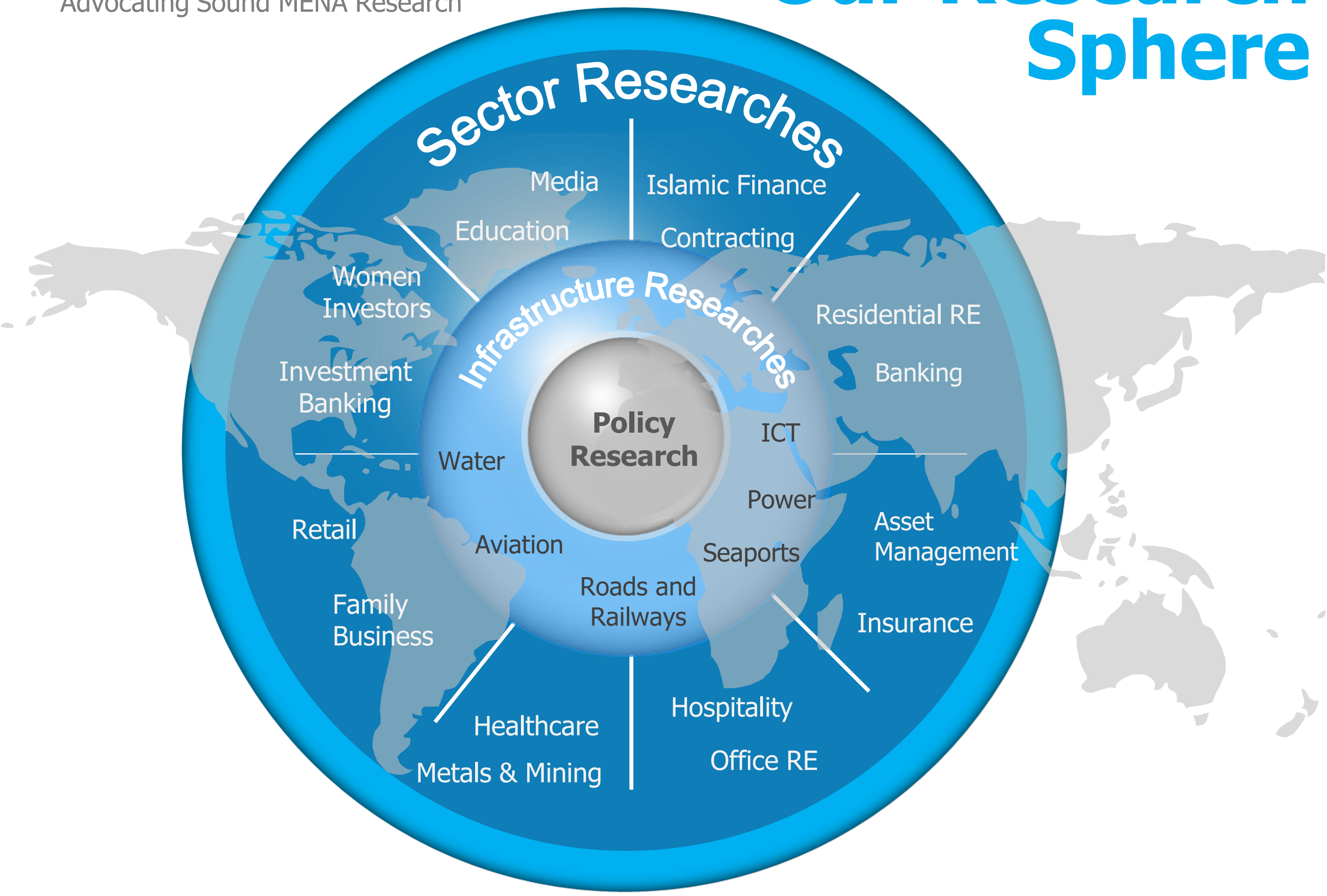

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