Date	10/02/2016
Rating Agency	**Capital Intelligence assigns a 'BBB' Rating to Burgan Bank's forthcoming Tier 2 KWD-denominated Bond**
Subject	Capital Intelligence (CI), the international credit rating agency, announced today that it has assigned a 'BBB' Rating to Burgan Bank's (BB) KWD-denominated subordinated Bond issue. The Outlook for the Bond is 'Stable'. The terms and conditions applying to the issue include a 'non-viability clause'. Accordingly, given the subordinated Bond's contractual point of non-viability loss absorption characteristics, the issue qualifies as Tier 2 Capital under the Central Bank of Kuwait's (CBK) Basel III implementation. This essentially allows the CBK – at its sole discretion – to require the Bond to be written off in its entirety. While there have been no clear guidelines issued as to what financial metrics would trigger this course of action, it has been assumed that such a trigger would not be activated as long as the capital adequacy of the Bank remains above the CBK's minimum (currently 12.5%) – with this calculation being made after the Bank has complied with mandatory provisioning requirements. Moreover, it is clear from the wording of the issue prospectus that either action would be expected to precede any governmental support being made available. Therefore, the starting point for assigning a rating has to be a rating that specifically excludes governmental support – i.e. the Financial Strength Rating (FSR) of the Bank. This is currently 'BBB+'. Given the specific features of the Bond issue (including its subordination), as well as the FSR assigned to the Bank and CI's view on how the CBK is expected to resolve a distressed bank, the assigned rating to the Bond is accordingly reduced by one notch to 'BBB'. As the adoption of Basel III in Kuwait is still a 'work in progress', it is likely that more detailed guidance on the issue of Basel III compliant debt capital instruments will emerge over time. Depending on their contents, the notching may change at some point in the future – either upwards or downwards. The Bond Rating is supported by the Bank's improved asset quality in recent years, comfortable liquidity, and large additions to capital, as well as the rebound in net profitability in 2014. BB's geographically diversified asset base and revenue streams are also a supporting factor, but to a lesser degree. The main constraining factor on the Rating is the subordinated nature of the obligation – and the impact on the instrument should the issuer encounter sufficiently serious adverse financial conditions. The Rating is also constrained by BB's high indirect exposure to non-investment grade sovereigns through its subsidiary banks, its considerable exposure to related parties, and by customer concentrations in deposits and to a lesser extent in loans (although both are to an extent systemic). Also constraining the Rating is the challenging regional operating environment exacerbated by a sharp fall in the oil price. BB, currently Kuwait's second largest conventional commercial bank by consolidated assets, is majority owned by Kuwait Projects Company Holding (KSC) (KIPCO). KIPCO, one of the largest holding companies in the MENA region, has held an effective controlling interest in the Bank for nearly two decades. BB's risk asset profile was significantly modified over the recent past after it acquired (and integrated) four MENA regional banks from KIPCO group sister company United Gulf Bank. While BB has become one of the most regionally diversified Kuwaiti commercial banks with a clear focus on the MENA region, the takeover of the bank subsidiaries also raised its risk exposure to low rated sovereigns (namely Jordan, Algeria, Iraq, Tunisia and, more recently, Turkey) from an earlier negligible level. The economy and operating environment in these countries remains challenging, while the underlying credit and political risks have

increased. As part of its capital optimisation programme, in December 2015, BB executed an agreement to sell its 51.19% equity stake in subsidiary Jordan Kuwait Bank to another KIPCO subsidiary.

Although the Bank's non-performing loans (NPLs) rose moderately in recent periods, following successive declines, the NPL to gross loans ratio remained at a very satisfactory level, while increased loan-loss reserves continued to provide more than full cover. This, together with a strong capital base, means that the Effective Coverage Ratio is also strong. Liquidity, as measured by key indicators, remains good and among the best in the Kuwaiti market, reflecting BB's slightly lower share of loans in total assets, combined with its larger stock of liquid assets. CI, however, notes that a significant proportion of this liquidity is at the subsidiary banks' level. The Bank's funding is sourced predominantly from customer deposits and these continue to grow at a healthy pace. BB allowed some relatively expensive customer deposits to run off in response to the successful capital increase in 2014. On a positive note, concentrations in the customer deposit base have reduced, placing the Bank in good stead given the prospect of tightening liquidity conditions in the Kuwaiti market in the near to medium-term and the associated increase in funding risk.

BB's balance sheet is comfortably capitalised, following a Perpetual Tier 1 issue, as well as the successful rights issue in 2014. This has helped maintain the capital adequacy ratio (CAR) at a satisfactory level, although the CAR declined as a result of Basel III implementation. Nonetheless, the Bank's leverage, as measured by the ratio of total capital to total assets, improved noticeably following the capital injection, and remained sound at mid-year 2015. This new Tier 2 (Basel III compliant) bond issue is expected to increase the CAR to a more comfortable level in the near term. Internal capital generation recovered in 2014 as a result of a rebound in net profitability and a significantly reduced dividend payout. However, while operating profitability has remained satisfactory, the return on average assets (ROAA) is moderate in part due to ongoing provision charges − including a significant level of general provisions. ROAA is nonetheless currently on par with the Kuwait sector average. Gross income generation remains good, reflecting multiple sources of revenue, while operating profitability at the current level provides the flexibility to step up provisioning if necessary.

BB commenced operations in 1977 as a government-owned bank. In 1997, the Bank was privatised with KIPCO obtaining control. During 2007, KIPCO increased its ownership in BB to 43.01%, cementing BB's status as the largest and core member of the KIPCO Group. The second largest shareholder is UGB (17.86%) in Bahrain. Through its domestic network of 27 branches, which is supplemented by 121 ATMs, the Bank provides corporate/commercial banking, as well as retail and private banking. As at end-June 2015, total assets rose to KWD7.98 billion (USD26.4 billion) and total capital reached KWD947mn (USD3.13 billion).

CREDIT RATINGS

Issue Rating	**Outlook**
BBB	**Stable**

Rating Drivers	Supporting the Rating • Significantly improved loan asset quality with strong loan-loss reserve (LLR) and Effective Coverage ratios. • Oversubscribed capital increase and successful USD500mn Perpetual Tier 1 issue in 2014. • Good liquidity, premised on deep base of customer deposit funding. • Net profitability recovered, though ROAA remains moderate in line with peer banks. • Established domestic franchise, complemented by diversified MENA regional presence. Constraining the Rating • The subordinated status of the obligation; conditions of issuance means government support to enable repayment of the bond is not assumed. • High indirect exposure to non-investment grade sovereigns through operating subsidiary banks. • Considerable and increased exposure to related parties. • Concentrations within the customer deposit base, although reduced, and to lesser extent in loans. • Challenging regional operating environment, exacerbated by sharp fall in the oil price.
Rating Impact on the Company's Status	No material impact
Rating Outlook	"Stable" Outlook