

S&P Ratings report for Burgan Bank : __July 2015

Issuer Credit Rating affirmed : BBB+ / Stable / A-2

"Major Rating Factors

Strengths:

- A geographically well-diversified lending book.
- Adequate capitalization and liquidity.
- Resilient operating income.

Weaknesses:

- Significant loan portfolio concentration and large related party exposures.
- Sizable overseas operations in riskier countries than the Kuwait home market.

Outlook: Stable

The stable outlook on Kuwait-based Burgan Bank reflects Standard & Poor's Ratings Services' expectation that the bank will maintain its risk-adjusted capital (RAC) ratio above 8.0% over the next 18-24 months. In addition, we project asset quality, profitability, and related party exposures at current levels during the same period.

We would consider a negative rating action on Burgan Bank in the unlikely scenario of significant deterioration in the bank's asset quality. Although we expect the operating conditions in Turkey to remain challenging, and conditions in Iraq precarious, we do not foresee major deterioration in the bank's asset quality over the next 18-24 months.

We could upgrade Burgan Bank if the operating environment of its overseas operations stabilizes and the bank displays a stronger track record of resilient profitability indicators. An upgrade could also follow a decrease in related party exposures to more manageable levels while asset quality indicators remain at current levels.

Rationale

We base our ratings on Burgan Bank on the bank's 'bbb-' anchor and our view of its "adequate" business position, reflecting its healthy market position in Kuwait and its geographically diverse revenue generation. We view the bank's capital and earnings as "adequate" as we expect our RAC ratio for the bank to remain above 8.0% over the next 18-24 months. We assess Burgan Bank's risk position as "moderate," given the high political and economic risk in some of the markets where it operates, as well as its high lending concentrations and large related-party lending exposures. We view the bank's funding as "average" and its liquidity as "adequate." We therefore assess the bank's stand-alone credit profile (SACP) at 'bb+'.

The long-term rating on Burgan Bank is three notches higher than the SACP, reflecting our view of a "high" likelihood that the government of Kuwait would provide extraordinary support to the bank in the event of financial distress. We classify Burgan Bank as having "high" systemic importance in Kuwait and consider Kuwait to be "highly supportive" of the banking sector.

Anchor: 'bbb-' to reflect blended economic risk

Under our bank criteria, we use our Banking Industry Country Risk Assessment economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating on a bank. We base the 'bbb-' anchor for Burgan Bank on our industry risk score of '5' for Kuwait (on a scale of 1-10, 1 indicating the lowest risk), where the bank is registered and regulated; and a blended economic risk score of '6'. The blended economic risk score is higher than that for Kuwait ('4') because of our higher economic risk scores for countries where the bank has its operations, such as Turkey ('6') and Jordan ('7'). We use the bank's exposure at default (EAD) at year-end 2014 for the calculation of the blended economic risk score. We consider that using EAD gives a better reflection than the bank's loan portfolio of the risks that Burgan Bank takes.

We view Kuwait's economy, which represents 40% of Burgan Bank's weighted economic risk, as having high accumulated wealth and very strong external and fiscal asset positions, backed by a significant stock of financial assets. We expect these strengths to offset risks related to the current volatile oil price, Kuwait's undiversified oil economy, and what we assess as a volatile and unpredictable political system, in addition to geopolitical tensions in the region. However, the generally high concentration in loan portfolios, and high concentration in real estate and construction, hamper Kuwaiti banks' credit profiles.

As regards to industry risk, we consider that Kuwait's banks have adequate pricing ability without significant market distortions because the competitive environment is stable. Funding conditions are favorable, in our opinion. We view Kuwait's overall institutional framework as a weakness despite recent improvements over the past few years, since we believe that the overall regulation and supervision of the wider Kuwaiti financial services market, including domestic investment companies, will remain a challenge for some time.

We could revise down our anchor for Kuwaiti banks if we revised down our industry risk score for Kuwait, although we view this as unlikely over the next 12-24 months, given that we assess the trend in Kuwait's industry risk as stable. Still, if this unlikely scenario materialized, we would review our assessments of the components of the SACP."
