Al-Tijari التجاري

TRANSLATION

Date: 18/12/2017
REF: CCG/105/2017

TO: Mr. Khaled Abdulrazaq Al-Khaled
Chief Executive Officer
Boursa Kuwait Securities Company

Greetings,

According to Chapter four (Disclosure of Material Information) of Rulebook ten (Disclosure and Transparency) of CMA Executive By-laws, kindly find attached the Annex No. (9) Disclosure of Credit Rating Form covering the updated credit rating report issued by Moody's on 18/12/2017.

Please note that there is no change from the previous credit rating opinion as issued in August 2017. Please also be advised that according to the issued report the Bank's rating was confirmed at A3 with a stable outlook.

Best Regards,

Yaqoub Habib Al-Ebrahim
Official Spokesman of CBK
GM, Compliance & CG

Copy to:
CMA / Manager, Disclosure Department

NOTE: This is a translation of the original for and binding Arabic text. In case of any difference between the Arabic and the English text, the Arabic text will be prevailing.

البنك التجاري الكويتي
Commercial Bank of Kuwait

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Annex (9)

Disclosure of Credit Rating Form

Date	18/12/2017
Name of Listed Company	Commercial Bank of Kuwait (K.P.S.C)
Entity who issues the rating	Moody's
Rating category	– Bank Deposits: A3/P-2 – Baseline Credit Assessment: ba1 – Adjusted Baseline Credit Assessment: ba1 – Counterparty Risk Assessment: A2(cr)/P-1(cr)
Rating implications	"Moody" applies special methodology when evaluating banks, the same can be found on the Agency website. The A3 long-term deposit rating assigned to Commercial Bank of Kuwait K.P.S.C. (CBK) incorporates four notches of uplift to the bank's standalone Baseline Credit Assessment (BCA) of ba1, reflecting our view of a very high probability of support from the Government of Kuwait (Aa2 stable) in case of need. The bank's short-term deposit rating is Prime-2. Furthermore, we have assigned a Counterparty Risk (CR) Assessment of A2(cr)/Prime-1(cr) to CBK. CBK's ba1 BCA reflects its (1) low levels of well-provisioned problem loans but also high credit risks, as indicated by its high credit concentrations and significant provisioning charges in recent years; and (2) strong core profitability and efficiency but low bottom-line earnings. The BCA also reflects the bank's deposit-based funding structure (despite some funding concentrations), comfortable liquidity buffers and solid capitalisation, with common Equity Tier 1 (CET1)/risk-weighted assets (RWA) of 17.5% as of the end of September 2017. Even though we expect only modest problem loan formation in Kuwait owing to pressure from low oil prices, political stress or a further sustained decline in oil prices pose downside risk.
Rating effect on the status of the company	The report reflects, as shown below, the strengths of the bank and the negative aspects of the financial situation, also addresses the changes in oil prices as the main engine of the local economy and that could put pressure on the bank's domestic asset quality.
Outlook	Stable. The stable outlook on CBK's ratings reflects the balance between the bank's strong revenue-generating capacity and solid capital and provisioning buffers against high credit concentrations and the recent high provisioning requirements.
Translation of the press release or executive summary	**Credit Strengths** – Strong core profitability. – Solid capitalization buffers to absorb unexpected credit losses. – Stable deposit base and significant liquidity buffers.

- Very high probability of systemic support, which underpins the bank's deposit ratings.

Credit Challenges

- Low problem loans, but high provisioning requirements and credit concentrations, point to elevated credit risks.
- Bottom-line earnings constrained by high provisions.
- Systemic funding concentrations, mostly to government-related entities.

Detailed Rating Considerations

Problem loans remain low, but high provisioning requirements and credit concentrations point to elevated credit risks:
CBK has drastically cut its problem loans/gross loans to just 0.5% as of year-end 2016 from 15.3% as of year-end 2010. Furthermore, the bank has built up substantial provisions against potential losses. Total provisions for impairment (including substantial general provisions) were equivalent to 5.9% of gross loans. Nevertheless, high provisioning expenses continued to weigh on CBK's performance, consuming around 80% of the bank's pre-provision income for the first nine months of 2017 on the back of writeoffs, specific provisioning, and booking of further general provisions, indicating elevated risks in the bank's portfolio. The significant 31% annual increase in these provisions as of September 2017 is also partly driven by an ongoing legal case. We expect the bank's provisioning requirements to remain high at year-end 2017.

Strong core profitability, but bottom-line earnings affected by high provisions:
CBK recorded exceptional operating efficiency, with cost/income of 32% for the first nine months of 2017 (2016: 28%), which is one of the best among its domestic peers, while the bank's pre-provision income at 2.4% of its average total assets was above the system average (of around 2.2%). However, its bottom-line profitability remained low, constrained by high provisions. The bank booked provisions of KWD60 million in the first nine months of 2017 against its pre-provision income of KWD75 million, compared with provisions of KWD46 million for the same period a year earlier, mainly as a result of a court verdict in February 2017. These high provisions led to net income/tangible assets of 0.4% for the first nine months of 2017, below the Kuwaiti banking system average. We expect CBK's bottom-line profitability to remain under pressure in fiscal 2017, owing to the high provisioning charges. Overall, we expect CBK to build the necessary provisions through revenues and without any impact on its capital base, and its bottom-line profitability to recover in 2018. We also expect that pre-provision income will be supported by improving margins as benchmark interest rates increase.

Solid capitalization buffers to absorb unexpected credit losses:
CBK reported a Basel III Tier 1 capital adequacy ratio (made up almost exclusively by CET1 capital) of 17.5% as of September 2017, well above the median of its similarly rated global peers and the current regulatory requirement. The Central Bank of Kuwait has fully implemented Basel III capital requirements, and CBK has to maintain CET1, Tier 1 and total capital ratios of 10.0%, 11.5% and 13.5%, respectively, since December 2016. These requirements include a 2.5% capital conservation buffer, but also a domestic-systemically important-bank surcharge of 0.5% specific to CBK.
CBK's equity/assets ratio was strong at 14.3% as of September 2017. The bank

	also reported a Basel III leverage ratio of 11.2% as of the end of September 2017, which compares well with those of its global peers. We expect CBK's capitalisation ratios to remain close to their current levels, reflecting our expectation of contained growth in the bank's RWA. The bank's Tier 1 ratio will remain above 14%, based on our stress scenario assumptions.