FitchRatings

Banks
Wholesale Commercial Banks
Kuwait

The Industrial Bank of Kuwait K.S .C.

Key Rating Drivers

The Industrial Bank of Kuwait K.S .C.'s (IBK) Issuer Default Ratings (IDRs) reflect potential support from the Kuwaiti authorities, if needed. This considers Kuwait's strong capacity to support the banking system and its record of supporting domestic banks. The Stable Outlook on IBK's Long-Term IDR reflects that on the Kuwaiti sovereign rating.

The 'F1' Short-Term IDR is the lower of two options mapping to an 'A' Long-Term IDR because a significant part of Kuwaiti banks' funding is related to the government, and financial distress for IBK would likely come at a time when the sovereign itself is experiencing some form of stress.

Government Support: The Kuwaiti authorities have strong ability and willingness to provide support to domestic banks irrespective of the banks' size, franchise, funding and level of government ownership. This view considers the authorities' record of support for the domestic banking system. High contagion risk among domestic banks is an added incentive for the state to provide support to any Kuwaiti bank if needed, to maintain market confidence and stability.

Recovering Operating Environment: Pressures from the Covid-19 pandemic and lower oil prices have receded, owing to the support of the Kuwaiti state and higher oil prices. Kuwaiti banks' credit profiles will remain resilient in 2022, supported by a sound regulatory framework, government spending and mild credit growth.

Policy Bank: IBK is Kuwait's sole development bank. The bank's primary focus is the provision of concessionary medium- and long-term financing for the establishment, expansion and modernisation of private-sector industries. The bank also provides commercial banking, mainly in the form of working capital, and its risk profile differs from that of commercial banks.

Exposure to Market Risk: IBK's investments are mainly in Kuwaiti government securities but also include international managed private equity funds and stakes in local industrial companies, which could lead to volatility in earnings.

Low Impaired Loans; Concentrated Book: IBK's impaired loans/gross loans ratio was a sound 0.03% at end-2021 due to non-performing loans (NPLs) write-offs. High loan concentration is a major constraint on asset quality but net loans account for a low proportion of total assets (end-2021: 38%) and non-loan assets (including financial investments) support asset-quality metrics.

Profitability Supported by Investment Income: Profitability is not IBK's main goal due to its development mandate. Fair-value gains on investments through the profit & loss account have supported the bank's profitability and almost doubled in 2021.

High Capital Ratios: IBK has high capital ratios by international standards, with a common equity tier 1 (CET1) ratio consistently above 40% in recent years (47.4% at end-2021). Nevertheless, Fitch Ratings sees these high ratios as necessary for the bank's concentration risks.

Mainly Funded by the State: IBK is heavily funded by the state. A KWD300 million subordinated loan from the Kuwaiti government maturing in 2027 comprised 70% of non-equity funding at end-2021. IBK views this funding as virtually perpetual and we believe that extensions to the loan are likely given the bank's state ownership and longstanding development role. IBK is restricted from taking retail deposits but can take corporate deposits. However, these account for a low proportion of the bank's total funding.

Ratings

Foreign Currency	
Long-Term IDR	A
Short-Term IDR	F1
Government Support Rating	a
Sovereign Risk (Kuwait)	
Long-Term Foreign-Currency IDR	AA-
Long-Term Local-Currency IDR	AA-
Country Ceiling	AA+
Outlooks	
Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (September 2022)

Related Research

Fitch Ratings 2022 Outlook: Middle East Banks (December 2021)

Fitch Downgrades Kuwait to 'AA-'; Outlook Stable (January 2022)

Fitch Affirms Industrial Bank of Kuwait at 'A'; Outlook Stable (April 2022)

Analysts

Ahmet Kilinc
+44 20 3530 1272
ahmet.kilinc@fitchratings.com

Jamal El Mellali
+44 20 3530 2763
jamal.elmellali@fitchratings.com

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

A downgrade of IBK's Long-Term IDR would require a downgrade of its Government Support Rating (GSR). The latter would likely stem from a weaker ability to support, as reflected in a Kuwaiti sovereign downgrade, which is not our base case considering the Stable Outlook on the sovereign rating.

A weaker propensity from the Kuwaiti authorities to support IBK would also lead to negative rating action, but this is unlikely in Fitch's view, given the strong record of supporting domestic banks.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of IBK's Long-Term IDR could come from an upgrade of its GSR. The latter would likely stem from a stronger ability to support, as reflected in a Kuwaiti sovereign upgrade. However, this is unlikely in the near term given the already high level of the GSR and the downgrade of the sovereign in January 2022.

Significant Changes from Last Review

Government Support Packages Expiring

Loan deferral programmes for all retail and corporate loans expired at end-1Q21. The extension of the retail loans deferral programme, only applicable to Kuwaiti nationals, also expired at end-3Q21. The capital conservation buffer of 2.5%, which was released during the pandemic, will be reinstated progressively to 1% starting 1 January 2022 and to 2.5% starting 1 January 2023. Similar to capital, regulatory liquidity requirements, which were relaxed during the crisis, will be reinstated in two phases. This includes the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) - reduced to 80% from 100% - which will be reinstated to 90% starting 1 January 2022 and to 100% starting 1 January 2023. Kuwaiti banks did not generally benefit from the relaxation in capital and liquidity regulatory requirements as the need did not arise.

Debt Issuance Likely to Slow

Although customer deposits remain the main source of non-equity funding (more than 85%), Kuwaiti banks increased their debt issuances from KWD475 million in 2019 to KWD714 million in 2020 and KWD1,142 million in 2021, reaching a total debt of KWD3,210 million at end-2021. Issuances are in the form of Tier 1 and Tier 2 capital, but also senior unsecured and certificates of deposits.

Kuwaiti banks benefit from their high Long-Term IDRs to issue debt at a lower rate in a low-interest-rate environment, replacing some high-cost term deposits and refinancing debts at a lower cost. Debt issuances also allow banks to obtain long-term funding to reduce their liquidity maturity mismatches, manage their NSFR, obtain foreign-currency funding and be present in the capital markets, particularly for any future funding needs. Fitch expects a slowdown in debt issuances in 2022 given the expected increase in interest rates and uncertainties in the debt capital markets but also due to higher oil prices, which support banking sector liquidity.

Company Summary and Key Qualitative Factors

Operating Environment

Sovereign Rating Downgraded

Fitch downgraded Kuwait to 'AA-' Stable from 'AA'/Negative on 27 January 2022, reflecting ongoing political constraints that hinder the country addressing structural challenges related to heavy oil dependence, a generous welfare state and a large public sector. Kuwait's exceptionally strong external balance sheet and vast net foreign assets underpin the sovereign rating.

Recovering Operating Environment

Pressures on the domestic operating environment from the pandemic and lower oil prices faded in 2021, allowing a mild recovery in real GDP growth to 2.4% in 2021 from a contraction of 8.9% in 2020. Higher oil prices should support government spending on wages and investments and help business confidence to recover. Fitch expects real GDP growth of 7.9% and bank credit growth in the mid-single digits in 2022. However, Kuwait's fiscal and external metrics will remain sensitive to oil revenue, and the private sector will remain heavily dependent on public spending.

Bank Resilience Due to Government Support

The Central Bank of Kuwait (CBK) has acted swiftly to help weather the impact of the pandemic crisis by cutting interest rates and relaxing capital and liquidity ratios, among other measures. The government's continuous spending, although at a slower pace, supported credit growth and obligors' repayment capabilities. Banks's asset quality will be resilient in 2022, as in 2021, supported by some restructuring and write-offs. Profitability will continue to improve in 2022 owing to higher business volumes and expected higher interest rates but will remain under pressure from low interest rates, continuous investments in digitalisation and high provisioning regulatory requirements. Capitalisation will remain adequate in 2022, supported by high loan loss allowances, mild growth, improved profitability and resilient asset quality. Funding and liquidity should remain strong in 2022, supported by large and stable deposits from government-related entities.

Business Profile

IBK was established in 1973 on the initiative of the government of Kuwait to promote domestic industrial development. It plays a key role in financing Kuwait's industrial sector. The state is IBK's largest shareholder, with a direct and indirect ownership of about 70%. IBK offers financing to Kuwaiti industrial enterprises through either medium- and long-term industrial loans (46% of gross loans at end-2021) at a preferential 3.5% fixed rate (usually five- to seven-year maturity) or commercial loans (54% of gross loans at end-2021) that are priced closer to market rates (largely short-term working capital to industries).

IBK's loan book accounted for only 38% of total assets at end-2021, mainly due to growth constraints in IBK's core business. IBK's non-lending activities include investments and treasury, aimed at deploying surplus liquidity and diversifying revenue. In addition to investments in CBK and domestic government bonds (19% of total assets at end-2021), IBK has investments (18% of total assets) primarily in well-known international private equity funds, but also holds bonds in domestic and foreign corporate bonds and stakes in local industrial companies.

As a development bank, IBK's strategic objectives are narrow and mostly dictated by the bank's policy role and public mandate. Low and volatile credit demand in the industrial sector has translated into difficulties expanding and stabilising the lending base. Gross loans have been declining since 2018. This has also pushed IBK to explore new opportunities to broaden lending sectors beyond industrial loans but this remains subject to approval from the Kuwaiti government and parliament.

Risk Profile

IBK's underwriting standards are pre-set by its mandate. The bank only lends to domestic industrial companies. The bank's loan book is split almost evenly between industrial loans and commercial loans, with no retail lending. Industrial loans are subsidised, generally medium-to-long term, and extended to new industrial projects or for the expansion of existing ones.

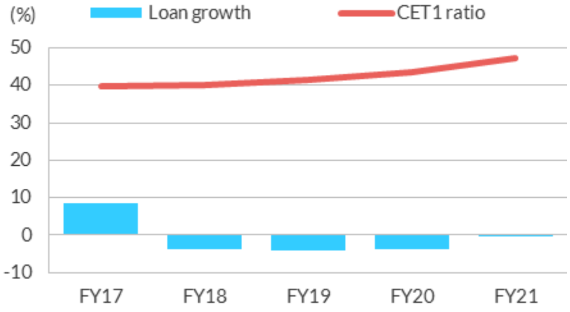
IBK uses the relationships developed by its industrial loans to garner new commercial customers (about 80% of its commercial customers are also industrial clients). However, the undiversified nature of business and lending leads to unavoidable high-sector and single-borrower concentrations and exposes IBK more to event risk than domestic commercial peers. The top 20 obligors represented about 69% of total gross loans at end-2021, or 124% of CET1.

Most of IBK's fixed-income investments relate to Kuwaiti government or CBK bonds. These are held for capital and liquidity purposes. IBK also holds investments at fair value through profit and loss that are diversified by geography and by asset class. Excess liquidity is managed conservatively by investing in sovereign debt and lending to the interbank market.

IBK also has other investments, primarily in international private equity (managed by third-party asset managers) and in domestic and foreign corporate bonds. Funds are about KD100 million, equivalent to about 35% of equity.

IBK has the largest securities portfolio relative to assets in the sector and this exposes the bank to market risk. IBK's interest-rate risk is low, with the bank almost exclusively funded by a KWD300 million (72% of non-equity funding at end-2021) 20-year loan from the Kuwaiti government. IBK pays a fixed annual interest rate of 0.5% on the amounts of industrial loan exposures (either disbursed amounts or undrawn commitments) and these loans are granted by the bank at preferential fixed lending rates. Margins on industrial loans are therefore not correlated with market rates. IBK pays three months' KIBOR-floating rate on the balance of the KWD300 million loan unused for industrial loans; these funds are deployed in floating-rate commercial loans.

Loan Growth



Source: Fitch Ratings, IBK

Financial Profile

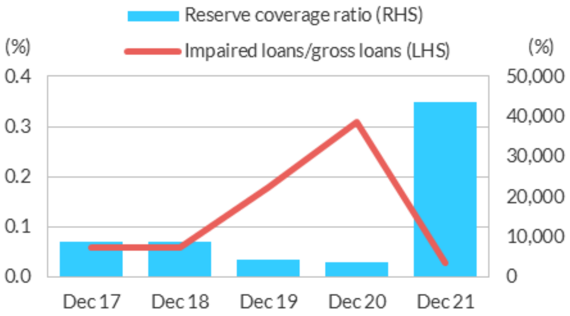
Asset Quality

IBK's impaired loans/gross loans ratio remained very low at 0.03% at end-2021 (end-2020: 0.3%) as write-offs in 2021 reduced the ratio further. We view IBK's asset quality as sensitive to economic cycles, which are particularly affected by the volatility and uncertainty of oil prices, with high loan concentrations creating risks of a quick build-up of problem assets.

However, the bank's Stage 3 loans ratio is relatively high at 7.9% and the difference between Stage 3 and impaired loans is mainly related to classification differences. In addition, Stage 2 loans accounted for a very high 28% of total loans at end-2021. This is also reflected in the high stock of restructured but performing loans, which accounted for 14% of gross loans at end-2021 and can reflect pressure on the loan book.

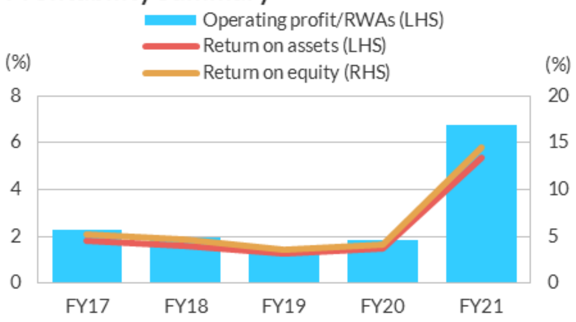
IBK's loan loss allowances coverage (loan loss allowance/gross loans: 13.9% at end-2021) is adequate given the bank's exposure to event risk. Non-loan assets, including financial investments, support asset-quality metrics. Securities (9% of total assets) are all in the form of highly rated Kuwaiti government bonds, and interbank placements (25% of assets) are almost all with Kuwaiti banks.

Asset Quality Summary



Source: Fitch Ratings, IBK

Profitability Summary



Source: Fitch Ratings, IBK

Earnings and Profitability

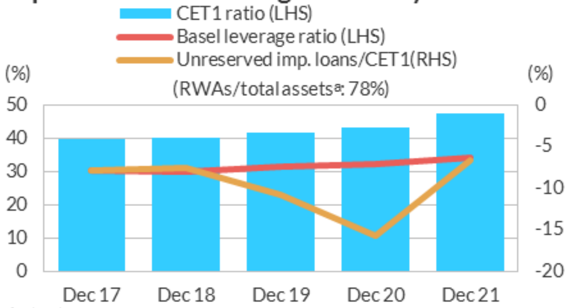
Profitability is not IBK's main goal due to its development mandate. The bank's net interest margin contracted about 50bp in 2021 due to lower yields on commercial lending. Fair-value gains on investments through the profit and loss account supported the bank's profitability in 2021 and the bank's net income nearly tripled. The Kuwaiti banks' provisioning policy is largely driven by the CBK, which stipulates the amount of precautionary reserves for each bank based on their assessment of the bank's risk profile.

In 2021, IBK generated revenues mainly in the form of net investment income (61% of total operating income; 2020:41%) and net interest income (24%), while the contribution from net fees and commissions was just 8%.

Capital and Leverage

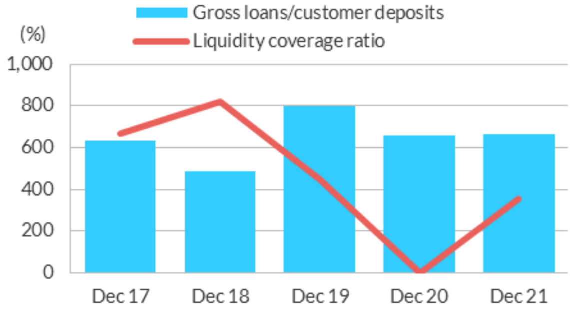
IBK has high capital ratios by international standards. While its total capital adequacy ratio (CAR) stopped benefiting from the KWD300 million subordinated loan from the state in 2014 with the implementation of Basel III in Kuwait, IBK's CAR remains among the highest in the region. Fitch's headline capital metric, the CET1 ratio, has been consistently above 40% in recent years (47.4% at end-2021) and IBK's Basel leverage ratio of 34% is far above the 3% requirement for Kuwaiti banks. Nevertheless, we see these high ratios as a necessity given the bank's concentration risks and sensitivity to economic cycles. In addition, these ratios have been kept at high levels due partly to subdued new business in recent years. They may decline if financing growth accelerates, which is not our base case.

Capitalisation & Leverage Summary



[a] Latest
Source: Fitch Ratings, IBK

Funding & Liquidity Summary



Source: Fitch Ratings, IBK

Funding and Liquidity

IBK's licence restricts it from undertaking any form of retail activity, including collecting retail deposits. IBK has some corporate deposits in the form of current accounts but these were a low 11% of non-equity funding at end-2021.

The bank is mainly funded by a 20-year KWD300 million subordinated loan from the Kuwaiti government equivalent to 70% of non-equity funding at end-2021, which matures in 2027. IBK considers this funding to be virtually perpetual and extensions to the loan are very likely given the bank's state ownership and development role. The remaining funding is KD36 million from banks and other financial institutions (8%) and term loans from two banks (11%).

Balance-sheet liquidity is strong with cash, short-term interbank placements, and Kuwaiti government treasury bills and bonds covering 72% of non-equity funding at end-2021 (238% if excluding the government loan). Most of IBK's liquid assets are in Kuwaiti dinars. IBK benefits from a very comfortable LCR ratio (346% end-2020) due to its very low net cash outflow. The bank's NSFR was at 146% at end-2020.

Financials

Financial Statements

	31 Dec 21		31 Dec 20	31 Dec 19	31 Dec 18
	Year end	Year end	Year end	Year end	Year end
	(USDm)	(KWDm)	(KWDm)	(KWDm)	(KWDm)
	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited – report not seen	Audited - unqualified
Summary income statement					
Net interest and dividend income	42	12.7	15.5	18.3	17.9
Net fees and commissions	15	4.4	3.9	3.8	3.9
Other operating income	117	35.3	15.1	14.8	14.0
Total operating income	173	52.4	34.5	36.9	35.8
Operating costs	48	14.6	11.1	11.5	10.7
Pre-impairment operating profit	125	37.8	23.4	25.4	25.1
Loan and other impairment charges	-5	-1.4	13.1	16.7	13.8
Operating profit	130	39.2	10.3	8.7	11.3
Other non-operating items (net)	n.a.	n.a.	n.a.	0.2	n.a.
Tax	3	0.8	0.2	0.1	0.2
Net income	127	38.4	10.1	8.8	11.1
Other comprehensive income	n.a.	n.a.	n.a.	n.a.	n.a.
Fitch comprehensive income	127	38.4	10.1	8.8	11.1
Summary balance sheet					
Assets					
Gross loans	1,065	322.1	323.2	335.9	350.1
- Of which impaired	84	25.5	1.0	0.6	0.2
Loan loss allowances	144	43.6	39.3	26.0	17.5
Net loans	921	278.5	283.9	309.9	332.6
Interbank	783	236.9	163.0	125.0	82.6
Derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Other securities and earning assets	692	209.4	206.5	220.3	263.4
Total earning assets	2,396	724.8	653.4	655.2	678.6
Cash and due from banks	27	8.2	23.7	18.2	5.9
Other assets	30	9.1	11.3	11.7	14.9
Total assets	2,453	742.1	688.4	685.1	699.4
Liabilities					
Customer deposits	160	48.3	48.9	41.9	72.3
Interbank and other short-term funding	1,112	336.4	44.2	40.6	24.3
Other long-term funding	154	46.6	331.9	345.6	345.9
Trading liabilities and derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Total funding and derivatives	1,426	431.3	425.0	428.1	442.5
Other liabilities	97	29.3	15.4	14.3	20.4
Preference shares and hybrid capital	n.a.	n.a.	n.a.	n.a.	n.a.
Total equity	931	281.5	248.0	242.7	236.5
Total liabilities and equity	2,453	742.1	688.4	685.1	699.4
Exchange rate		USD1 = KWD0.3025	USD1 = KWD0.3036	USD1 = KWD0.30305	USD1 = KWD0.30355

Source: Fitch Ratings, Fitch Solutions, IBK

Key Ratios

	31 Dec 21	31 Dec 20	31 Dec 19	31 Dec 18
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	6.7	1.8	1.5	2.0
Net interest income/average earning assets	1.8	2.4	2.8	2.7
Non-interest expense/gross revenue	28.2	32.0	31.2	30.1
Net income/average equity	14.5	4.2	3.6	4.7
Asset quality				
Impaired loans ratio	0.03	0.3	0.2	0.1
Growth in gross loans	-0.3	-3.8	-4.1	-3.6
Loan loss allowances/impaired loans	43,600.0	3,930.0	4,333.3	8,750.0
Loan impairment charges/average gross loans	-0.4	3.8	4.7	3.9
Capitalisation				
Common equity Tier 1 ratio	47.4	43.4	41.5	40.2
Fully loaded common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fitch Core Capital ratio	n.a.	n.a.	n.a.	41.2
Tangible common equity/tangible assets	37.9	36.0	35.4	33.8
Basel leverage ratio	34.3	32.4	31.6	29.8
Net impaired loans/common equity Tier 1	-15.8	-15.8	-10.7	-7.5
Net impaired loans/Fitch Core Capital	n.a.	n.a.	n.a.	-7.3
Funding and liquidity				
Gross loans/customer deposits	666.9	660.9	801.7	484.2
Liquidity coverage ratio	355.4	n.a.	444.0	822.3
Customer deposits/total non-equity funding	11.2	11.5	9.8	16.3
Net stable funding ratio	146.1	n.a.	152.1	149.5

Source: Fitch Ratings, Fitch Solutions, IBK

Support Assessment

Policy Banks: Government Support	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	A or A-
Actual jurisdiction D-SIB GSR	a
Government Support Rating	**a**
Government ability to support D-SIBs	
Sovereign Rating	AA-/ Stable
Sovereign financial flexibility (for rating level)	Positive
Government propensity to support D-SIBs	
Resolution legislation	Neutral
Support stance	Positive
Government propensity to support bank	
Systemic importance	Neutral
Liability structure	Positive
Ownership	Neutral
Policy role and status	
Ownership	Notched Down
Policy role	Notched Down
Guarantees and legal status	Equalised

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

Fitch's assessment of potential government support to Kuwaiti banks, if needed, factors in the sovereign's strong ability to provide support, as reflected in the sovereign rating (AA-/Stable), underpinned by Kuwait's exceptionally strong external balance sheet and vast net foreign assets. Fitch's assessment also factors in the sovereign's strong willingness to provide support irrespective of the banks' size, franchise, funding structure and level of government ownership. This view is reinforced by the authorities' record of support for the domestic banking system.

The CBK operates a strict regime with active monitoring to ensure the viability of banks, and has acted swiftly in the past to provide support when needed. This view considers the high contagion risk given the small number of banks and high concentration of banks in the system, as well as the importance of maintaining the soundness and reputation of the banking system. As a result, the GSRs of all Kuwaiti rated banks are the same as the domestic systemically important bank GSR of 'a', with the exception of National Bank of Kuwait S.A.K.P. (a+) given the bank's flagship status, its role in the Kuwaiti banking sector and its close business and strategic links with the state.

Environmental, Social and Governance Considerations

Overall ESG

5	
4	
3	
2	
1	

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

Environmental (E)

General Issues	Score	Impact	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1		n.a.	n.a.	5
Energy Management	1		n.a.	n.a.	4
Water & Wastewater Management	1		n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1		n.a.	n.a.	2
Exposure to Environmental Impacts	2		Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	1

Social (S)

General Issues	Score	Impact	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2		Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3		Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2		Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	3
Employee Wellbeing	1		n.a.	n.a.	2
Exposure to Social Impacts	2		Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	Score	Impact	Sector-Specific Issues	Reference	G Scale
Management Strategy	3		Operational implementation of strategy	Business Profile (incl. Management & governance)	5
Governance Structure	3		Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3		Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3		Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
					1

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.