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Industry Report Card:

Gulf Banks Are Weathering The Storm But Still Face Tight Liquidity

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Table Of Contents

The GCC Economic Environment Is Slowly Improving

The Price Tag Exceeds $20 Billion

Structural Factors Still Underpin Banks' Profitability

Asset Quality Has Almost Bottomed Out

Liquidity Has Improved Thanks To Government Support

Capital: A Relative Strength

Our Rating Actions In The Past Six Months

Issuer Review

Rating Activity

Contact Information

Related Criteria And Research

Industry Report Card:

Gulf Banks Are Weathering The Storm But Still Face Tight Liquidity

After spending more than $20 billion on loan loss provisions and investment impairments since 2008, the Gulf banks that we rate appear to be showing signs of improvements. Thanks to high oil prices and government policies, Standard & Poor's Ratings Services believes that economies in the Gulf Cooperation Council (GCC)--comprising Saudi Arabia, Kuwait, Bahrain, Qatar, the United Arab Emirates (UAE), and Oman--are showing signs of recovery. We believe the asset quality of Gulf banks should improve from 2011 and that their good margins and efficiency will provide a solid foundation for their return to high profitability.

But challenges lie ahead. Improving liquidity, funding future growth, and refinancing the stock of existing debt are the next hurdles facing Gulf banks. We believe that the defaults of the Saad and Algosaibi Groups, the restructuring of Dubai World, and the concerns that financial difficulties may spread to other Dubai-based government-related entities (GREs) have somewhat dampened global market access to the GCC-based financial institutions.

On a positive note, Gulf banks are slowly rebuilding their stock of liquidity to face upcoming maturities, and have revised downward their growth strategies. We also classify the six GCC countries as "interventionist" toward their banking systems, meaning that we believe that these countries are highly likely to provide extraordinary support to their highly systemically important banks in case of need. Such support, as we have seen in the recent past, could ease the pressure on Gulf banks' liquidity.

Other positive factors for most Gulf banks we rate include their good capitalization. Standard & Poor's calculates its average risk-adjusted capital (RAC) ratio for Gulf banks it rates at 10.2% before adjustments at year-end 2009, or almost twice the average ratio for the top 45 banks in the world. In our opinion, this provides a sturdy shelter from unexpected shocks.

Over the past six months, we have taken a range of rating actions on Gulf banks. We changed the outlooks on some Kuwaiti banks to stable from negative, and upgraded two Saudi Arabian banks to reflect our views of their resilience. We also raised the ratings on UAE-based Mashreqbank after we reassessed the likelihood of extraordinary government support it is expected to receive in case of need. However, we also took some negative rating actions on other UAE-based banks. This was due to uncertainties surrounding their exposure to Dubai World and other Dubai-based GREs, as well as significant exposure to the real estate sector, which in our view has weakened their stand-alone credit profiles (SACP). Indeed, the majority of our outlooks on the ratings of UAE banks remain negative to reflect our views about their operating environment. For additional information about our rating actions over the past six months, see table 3.

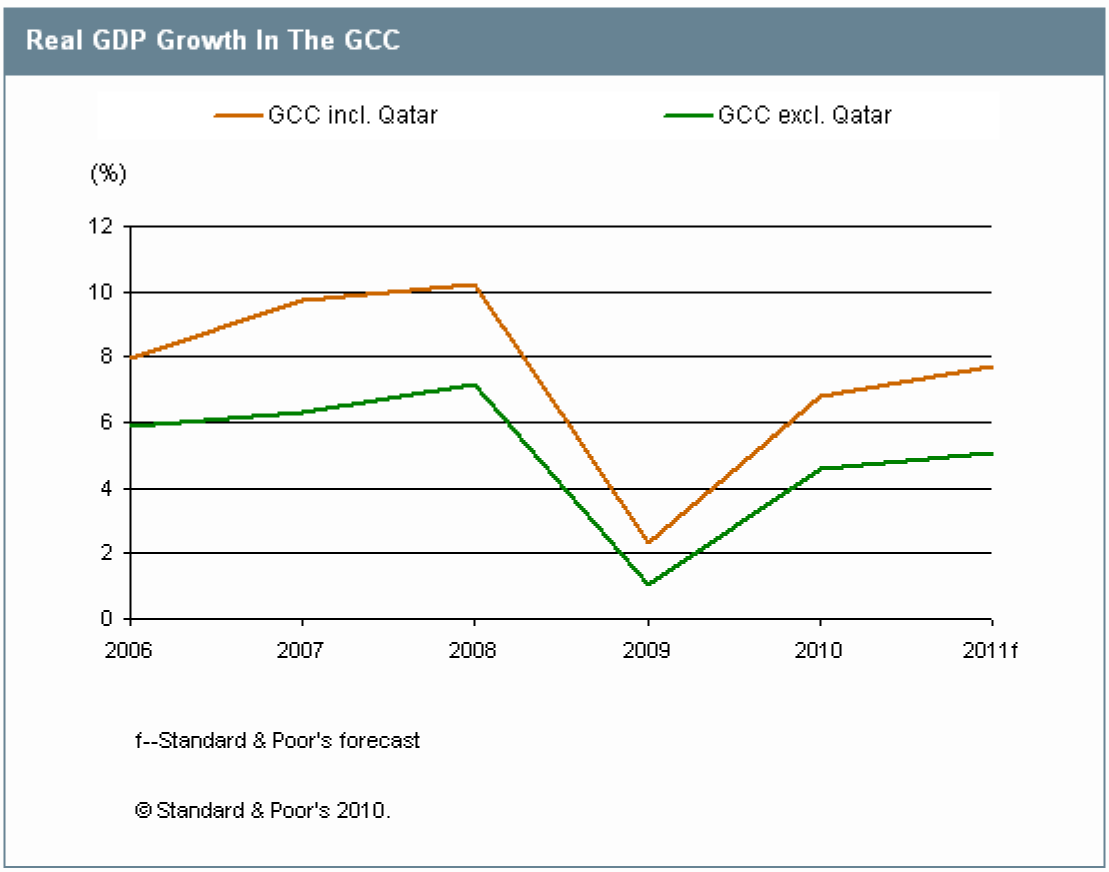
The GCC Economic Environment Is Slowly Improving

Over the past couple of quarters, we have started to see an improvement in GCC economies. Thanks to high oil prices and the support provided by some GCC governments, we forecast that real GDP growth (simple average) in the region will reach 6.8% for 2010 before rising in 2011 to 7.7% (see chart 1). This performance takes into account our expectation of very rapid growth in Qatar, which we estimate will reach 18.1% by the end of this year and 20.8% in 2011, thanks to the pick up in gas production. Excluding Qatar, we estimate the five remaining GCC countries should grow by an average of 4.6% in 2010, compared with 1.0% in 2009.

While many countries would be happy with such performance, we still see underlying risks in some sectors. Headline growth will come mainly from the hydrocarbon sector-—based on our central assumption that oil prices will remain around their current levels--alongside government support, which has come mostly in the form of infrastructure projects. But we still expect some vital sectors to remain severely challenged.

In most GCC countries, the real estate sector is one of the hardest hit. Overbuilding during the last credit cycle has caused real estate prices to drop almost everywhere. We believe that the correlation between the real estate industry and other sectors in the GCC countries—-such as building materials and retailing--will also likely soften the recovery of the private sector economy. Saudi Arabia is an exception, though, as we believe its population growth and age will still support the property market.

Chart 1



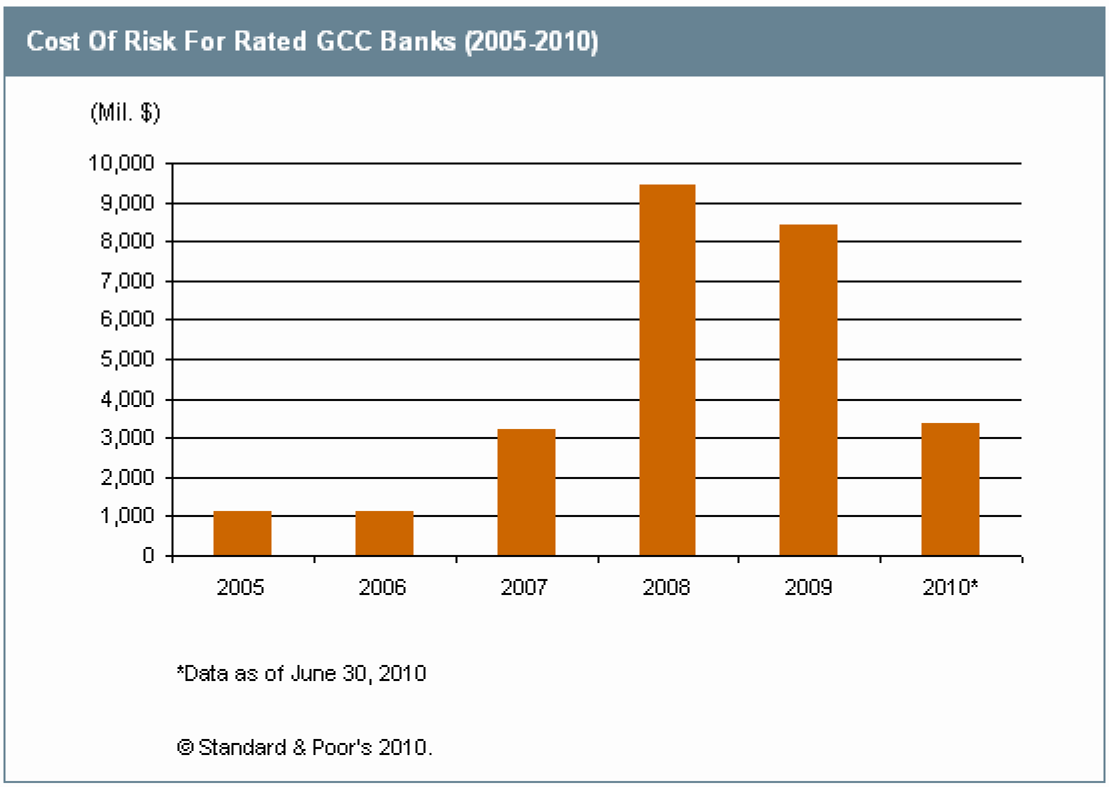
The Price Tag Exceeds $20 Billion

We estimate that the cost of the economic and financial troubles for GCC banks we rate so far exceeds $20 billion, since 2008 (see chart 2). We calculated this by adding rated Gulf banks' total new loan loss provisions to impairment charges on securities, minus the recoveries they had on their impaired loans and securities. We expect additional provisions to be forthcoming for these banks, which we believe will mainly come from:

- The still uncovered portion of their exposure to Saad and Algosaibi;
- The exposure to Dubai World, the cost of which is uncertain until its creditors sign the restructuring agreements. The final cost will depend on the terms of the agreements relative to the original terms of the Dubai World loans. The uncertainty regarding other Dubai-based GREs is another source of potential provisions for Gulf banks; and
- To a lesser extent, the deterioration in some sectors, such as real estate and its related industries, the retail sector, and particularly the expatriate segment. We have noted an increase in nonperforming loans from these sectors in the past 18 months.

Once these exposures are finalized, we expect to see a decline in the banks' provisioning needs. We believe they will descend levels comparable to those of 2005-2006.

Chart 2



The total cost of the economic disruption by country shows that Kuwaiti banks contributed a 33.6% (see chart 3). Oman and Qatar cost the least, at 2.0% and 3.8% respectively. In our view, the main reasons for these results were:

- The Kuwaiti banks' exposure to investment companies and real estate intermediation companies that suffered sizable losses over the past two years, which necessitated significant provisions;
- The alleged fraud involving Kuwait-based Gulf Bank, which resulted in the booking of $1.4 billion of new provisions in 2008, and wiping out its capital base;
- We only rate one bank in Oman--Bank Muscat--whose total amount of provisions was relatively low compared with the other GCC banks. This bank controlled a market share of about 40% of the system assets at year-end

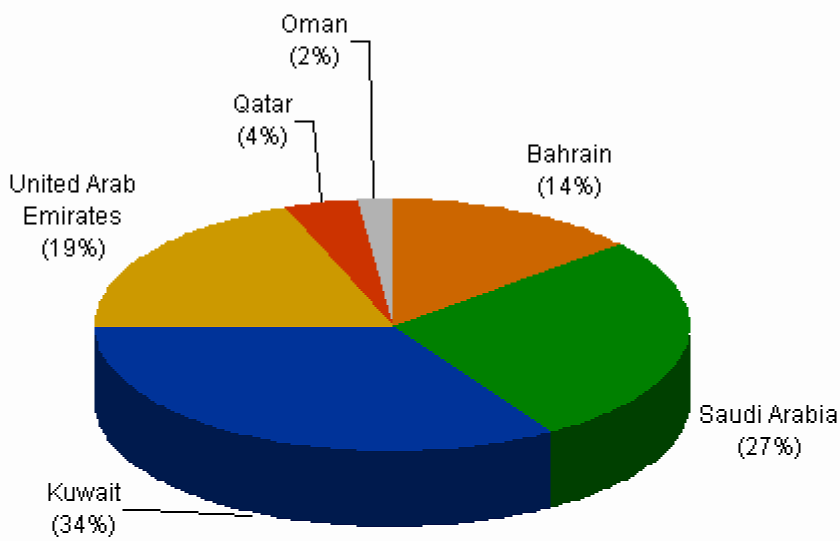
2009, however; and

- The Qatari government intervened massively to shield its banking system from the stock market and real estate correction. This resulted in a much lower cost of risk, though we understand from discussions with Qatari banks that there have been no major defaults in the real estate loans sold to the Qatari government despite the correction.

Saudi Arabia was the second main contributor to the cost of risk. But this is explained by the default of Saad and Algosaibi, as well as the relatively large provisions allocated by National Commercial Bank to cover for its exposure to structured investment products in 2008, and more generally the larger size of the Saudi banking system compared with other systems in the GCC. Finally, Bahrain's sizable contribution mainly stems from the wholesale banks that we rate--namely Gulf International Bank and Arab Banking Corp-- which had to allocate large provisions to cover their exposures to structured investment products in 2008.

Chart 3

Breakdown Of The Cost Of Crisis By Country (2008-2010)



Note: Data as of June 30, 2010

Structural Factors Still Underpin Banks' Profitability

Although several Gulf banks have booked large provisions, we believe that structural factors still support their intrinsic profitability. The commercial banks have a relatively ample interest margin, which we estimate at about 3.0% during the first half of 2010 and which has been almost stable for the past five years. In our view, Gulf banks have been extremely adept at adjusting their interest margin to the changing environment (see chart 4). In the next few quarters, we expect interest margins will remain generally at their current levels, albeit narrowing slightly because of the pressure on the funding base of some banks and their willingness to attract additional deposits offering higher rates.

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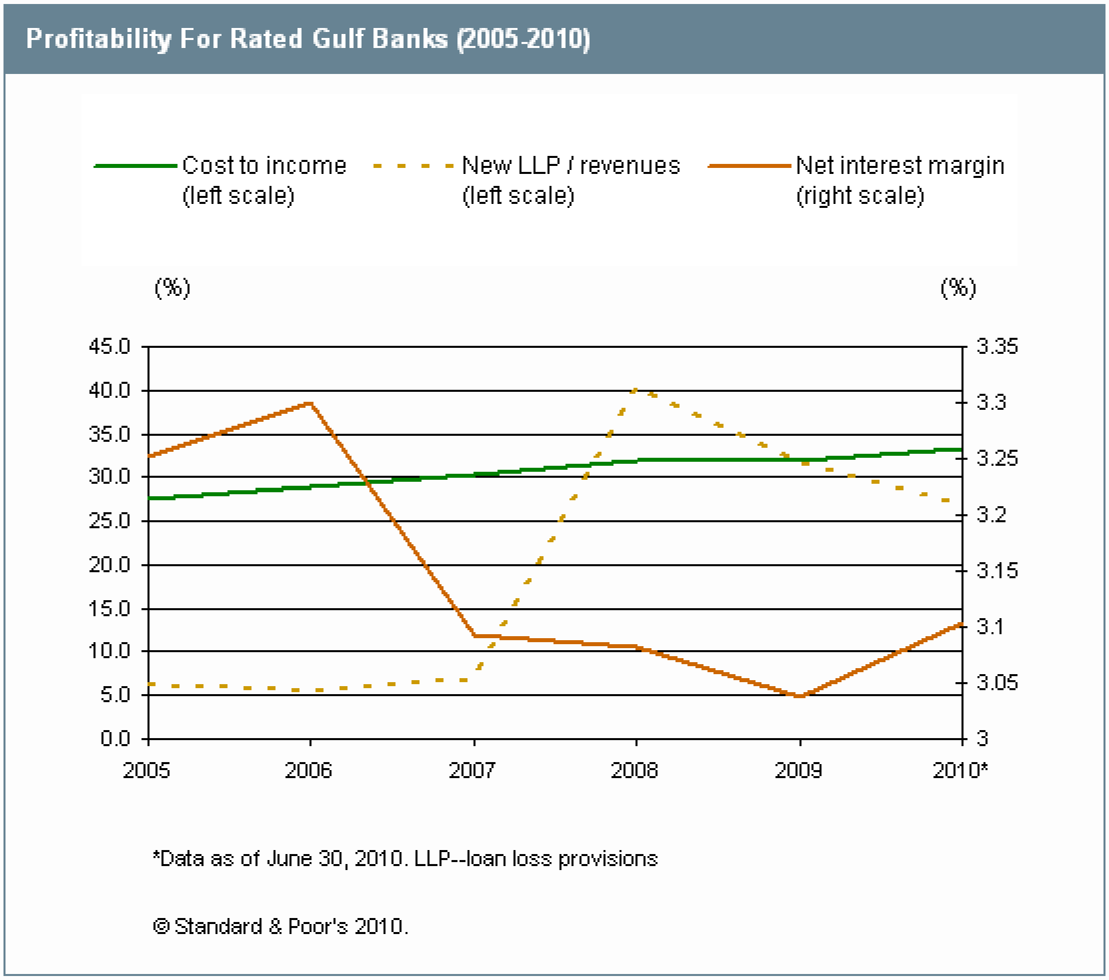
Chart 4



Gulf banks are also highly efficient by Western standards. For the commercial banks that we rate, the cost-to-income ratio stood at 33.1% on average during the first half of 2010. We expect this trend to continue thanks to the region's low cost of labor and the absence of taxes compared with western countries (see chart 4 above). Overall, the core earnings-to-total assets ratio for these banks stood at 1.8% in the first of half of 2010 compared with 1.6% in 2009, which we consider an adequate performance.

Asset Quality Has Almost Bottomed Out

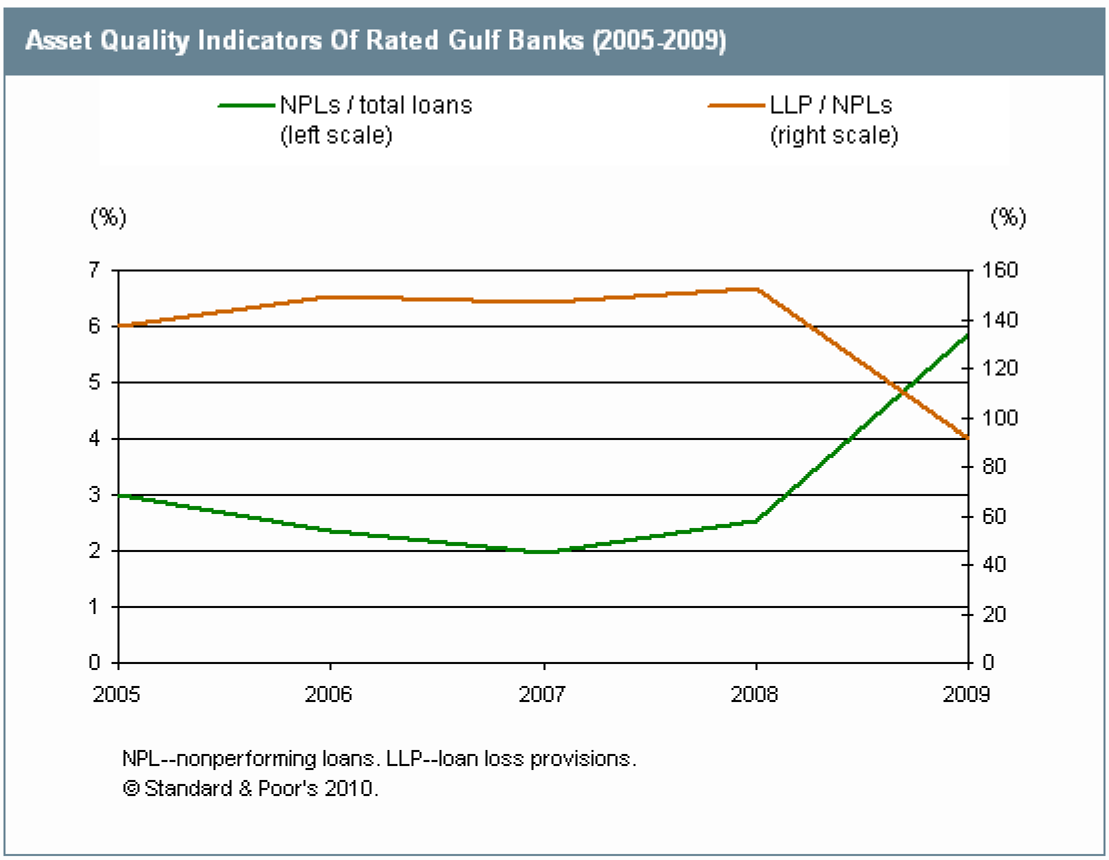
Asset quality indicators of Gulf banks that we rate have deteriorated in the past couple of years (see chart 5). We see this weakening resulting from:

- A slowdown in the local economies, coupled with specific deterioration in certain economic sectors, notably real estate in the UAE and the investment companies sector in Kuwait; and
- The Saad and Algosaibi defaults, to which we estimated the exposure of rated Gulf banks at $9.7 billion (see "Special Standard & Poor's Survey Shows That Rated Gulf Banks Are Significantly Exposed To The Saad And Algosaibi Groups," published July 23, 2009).

We expect to see additional deterioration in the asset quality indicators of Gulf banks, which we believe will stem mainly from the retail and real estate sectors. We think that the resolution of Dubai World's restructuring and the risk that problems could spread to other Dubai-based GREs are other sources of risk for asset quality indicators. But once the Dubai World case is sorted out, we expect the banks' asset quality will likely bottom out by year-end 2010.

Our opinion factors in the assumption that the economic recovery tracks our expectations and that the local governments continue to support their economies. One noticeable exception is Qatar where local banks' asset quality indicators deteriorated only slightly thanks to government support through the buyback of a portion of the banking system exposure to the real estate sector and other loans. Without this government intervention, we believe that we would have seen more rapid deterioration in the asset quality indicators of Qatari banks.

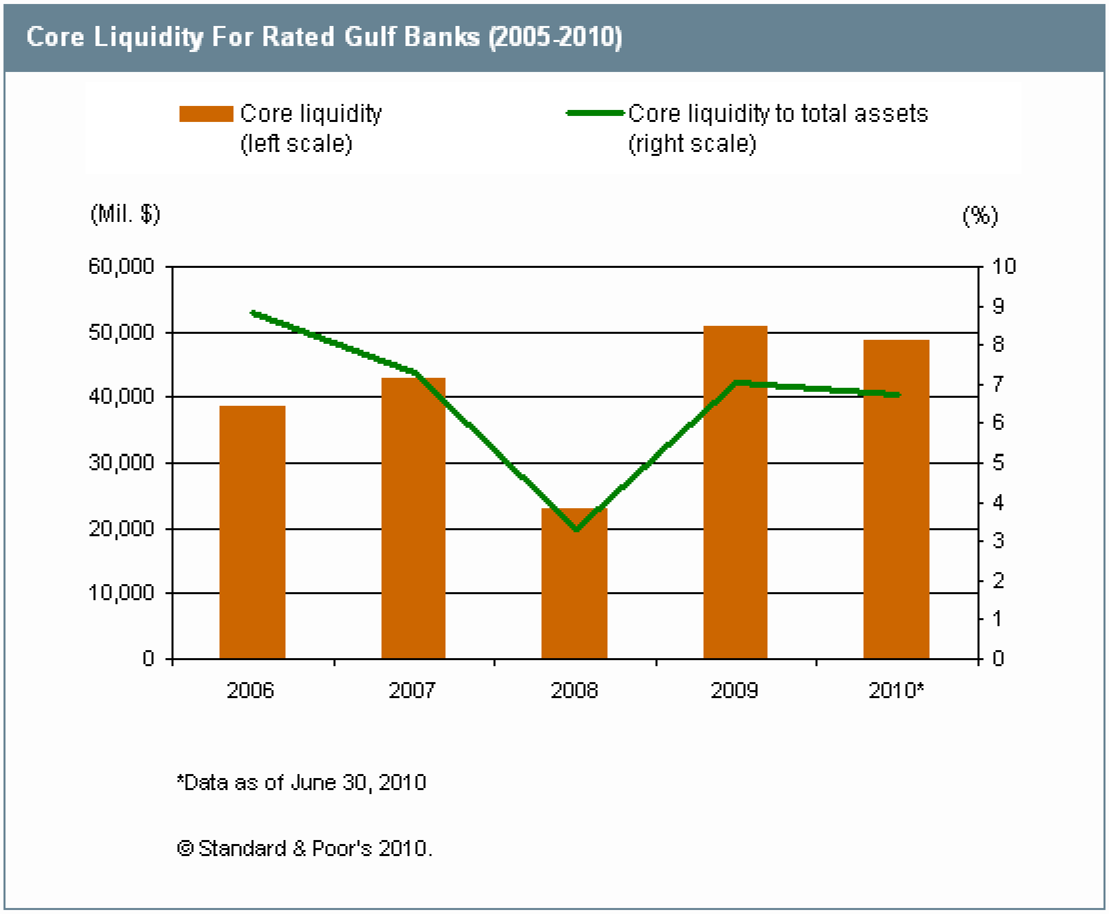
Chart 5



Liquidity Has Improved Thanks To Government Support

During the last 12 months, we have seen GCC governments intervening to ease the liquidity deterioration in their banking systems. Meanwhile, the banks themselves have adjusted their strategies to put liquidity at the top of their agendas. As a result, the core liquidity--defined as total cash and money market instruments minus interbank borrowings--of the GCC commercial banks we rate improved to reach $48.8 billion on June 30, 2010, compared with $22.8 billion at year-end 2008, or 6.7% of total assets versus 3.3% (see chart 6).

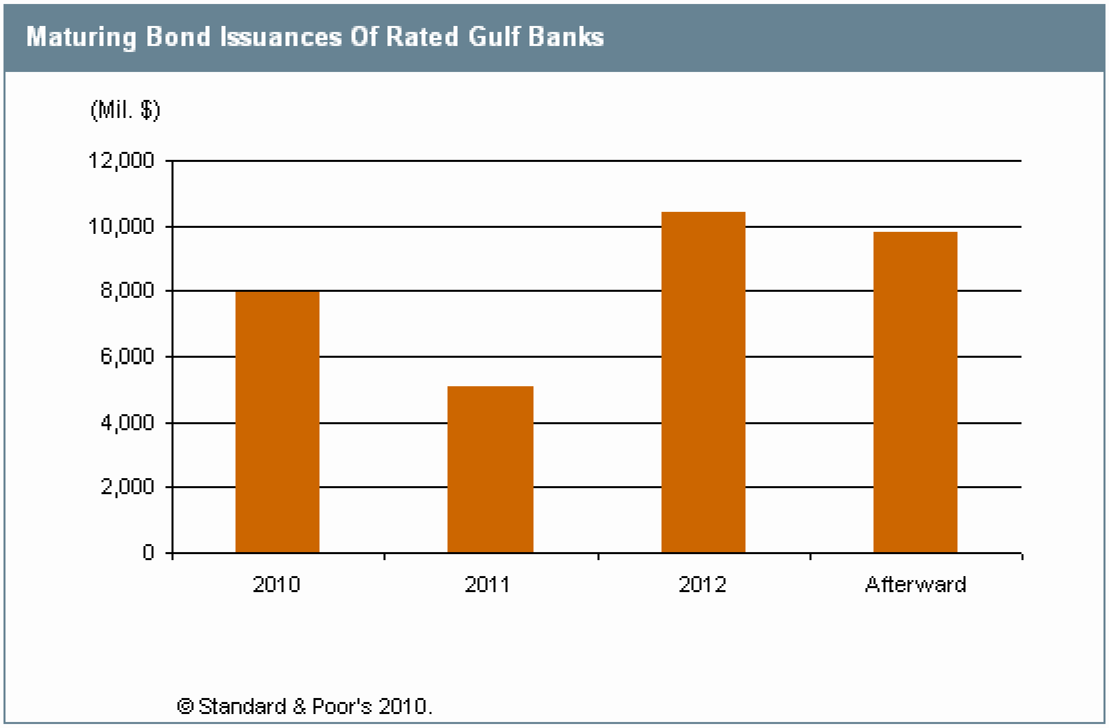
Chart 6



We expect liquidity indicators of these Gulf banks to remain relatively weak for the next few quarters. Indeed, over the past five years, Gulf banks have accessed international capital markets to raise alternative funding sources. Some of the bonds that were issued at that time will mature by 2011 and afterward (see chart 7). With the Saad and Algosaibi defaults, the Dubai World uncertainty, and concerns that similar problems might spread to other Dubai-based GREs, we believe that many banks could have trouble accessing the international markets to refinance debt coming to maturity, unlike in the previous five years.

On a positive note, well-established names have seen a reopening either in the international markets or in neighboring markets, where some pockets of liquidity are still available. The National Bank of Abu Dhabi, for example, issued a sukuk in Malaysia for a total amount of $159.4 million in June 2010. Abu Dhabi Commercial Bank followed, issuing a bond on the same market for a total amount of $239.5 million in August 2010. In addition, Gulf banks we rate have gone to great efforts to raise their deposit bases over the past couple of quarters in order to reduce their loan-to-deposit ratios. The overall ratio stood at 95.5% on June 30, 2010, compared with 99.2% at year-end 2008.

Chart 7

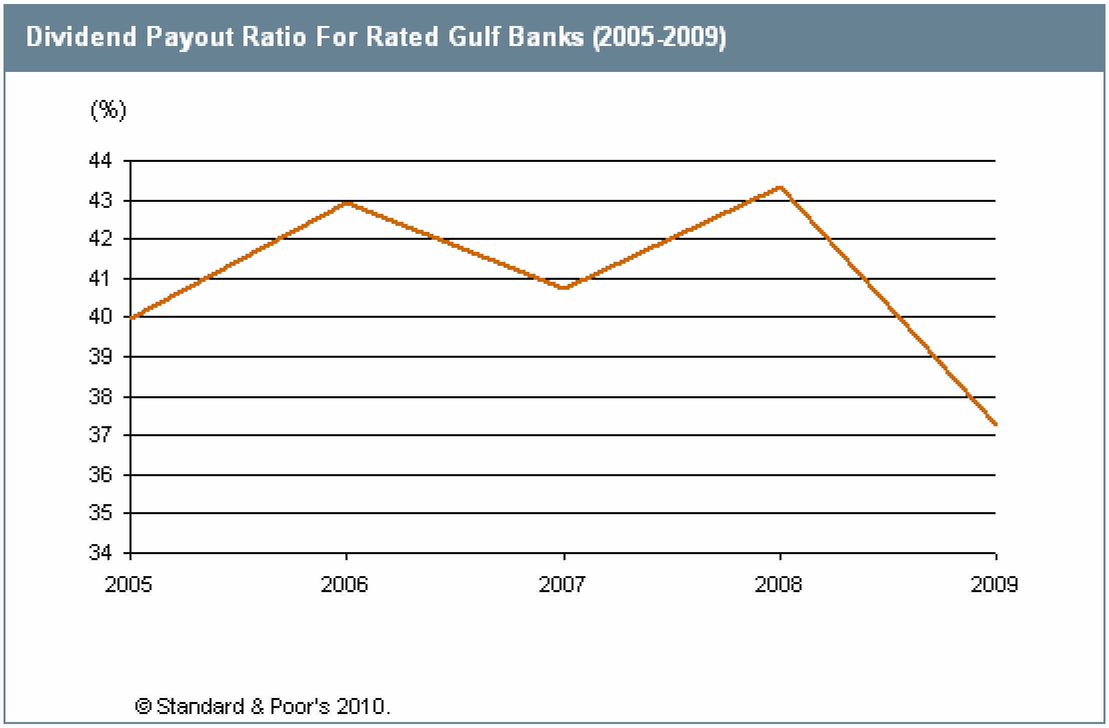


Capital: A Relative Strength

We view the capitalization of Gulf banks as a relative strength for their ratings. With an average risk-adjusted capital (RAC) ratio before adjustments, which is a Standard & Poor's calculation, of 10.2%, Gulf banks display almost twice the level of capitalization of the top 45 banks in the world. However, the region's recent corporate defaults highlight Gulf banks' sizable exposure to concentration risks. Our average RAC ratio for these banks declines to 8.7% when we take into account capital charges for geographic, single-name concentration, and other adjustments.

Gulf banks tend to benefit from above-average financial flexibility because they can turn to shareholders to raise additional capital. The track record for raising capital appears bright for most Gulf banks, enabling us to adopt a more favorable view of the commitment of shareholders or authorities toward their banking system. We classify the six GCC countries as interventionist toward their banking system and believe that government support for highly systemically important banks would be likely if the need arises and this is reflected in their ratings. Finally, over the past couple of years we have observed a significant reduction in dividend pay-out ratios as Gulf banks attempted to bolster their capitalization using internal sources (see chart 8).

Chart 8



Our Rating Actions In The Past Six Months

We have taken a range of rating actions on Gulf banks over the past six months. We changed the outlooks on some Kuwaiti banks to stable from negative, and upgraded two of Saudi Arabian banks on the back of to their strong resilience. We also raised the ratings on UAE-based Mashreqbank after we reassessed the likelihood of extraordinary government support we expected it would receive in case of need.

However, we also took some negative actions on UAE-based banks due to uncertainties surrounding their exposure to Dubai World and other Dubai-based GREs, which weakened their SACPs. In particular, we revised the outlooks on Mashreq, Dubai Islamic Bank, and Abu Dhabi Commercial Bank to negative. For additional information about our rating actions in the past six months, see table 3. The majority of the outlooks on the ratings of UAE banks remain negative to reflect our views about their difficult operating environment.

Table 1

Gulf Region Sovereign Ratings And Banking Industry Country Risk Assessments (BICRAs)

Country	Sovereign credit rating (foreign currency)	BICRA
Bahrain (Kingdom of)	A/Stable/A-1	5
Kuwait (State of)	AA-/Stable/A-1+	5
Oman (Sultanate of)	A/Stable/A-1	5
Qatar (State of)	AA/Stable/A-1+	4
Saudi Arabia (Kingdom of)	AA-/Stable/A-1+	3
United Arab Emirates	Not rated	4
Abu Dhabi (Emirate of)	AA/Stable/A-1+	N/A

Table 1

Gulf Region Sovereign Ratings And Banking Industry Country Risk Assessments (BICRAs) (cont.)		
Ras al-Khaimah (Emirate of)	A/Stable/A-1	N/A

Ratings are as of Sept. 1, 2010. Source: Standard & Poor's. N/A--Not applicable.

Issuer Review

Table 2

Company/Ratings/Comments	Country	Analyst
Abu Dhabi Commercial Bank (A/Negative/A-1) The negative outlook reflects Standard & Poor's expectation that ADCB's business and financial profile will remain under strain, and lead to further asset-quality deterioration and a continued weakening of financial performance. Under our base case scenario, we expect the bank's financial profile to remain in line with its stand-alone credit profile (SACP). However, if the bank's financial profile weakens more than we currently expect, we would consider a negative rating action. A positive rating action appears remote in the foreseeable future, because it would hinge on a major improvement in the bank's operating environment and a significant improvement in its SACP.	United Arab Emirates	Goeksenin Karagoez
Ahli United Bank B.S.C. (A-/Stable/A-2) The stable outlook reflects our opinion that AUB will maintain its leading commercial position in Bahrain and good geographic diversification, but also that capitalization and profitability levels will be below those of peers'. The future direction of the ratings will largely depend on the bank's capitalization, the main constraint on the ratings, and its ability to maintain the current level of asset quality. A material decline in capitalization or tightening of liquidity might trigger a downgrade. We could raise ratings if capital ratios increase substantially and, at the same time, the group maintains its good asset quality and strengthens its funding and liquidity profile.	Bahrain	Goeksenin Karagoez
Al Ahli Bank of Kuwait (BBB+/Stable/A-2) The stable outlook reflects our view that ABK's capitalization and preprovision earnings generation capabilities are likely to remain at current levels, offering a buffer against the possibly sustained pressure on asset quality. We also expect authorities' ongoing funding support for ABK to remain in place. We would take negative view of any higher-than-expected deterioration in asset quality or funding, or any shift toward higher growth or risk appetite could weaken ABK's financial profile. We would consider positively a material diversification in lending and funding, an improvement in asset quality metrics, and a sustainable strengthening in ABK's business profile.	Kuwait	Paul-Henri Pruvost
Albaraka Banking Group (B.S.C.) (BBB-/Stable/A-3) The stable outlook reflects our expectations that the group's business and financial profile will remain relatively unchanged in the medium term. It also factors in ABG's ongoing efforts to implement common risk management practices, maintain groupwide asset quality metrics, and extract larger economies of scale. We also assume that ABG will maintain an estimated risk-adjusted capital (RAC) ratio, a Standard & Poor's calculation, after adjustments at least at current levels over the medium term. Therefore, we would likely lower the ratings on ABG if capitalization or asset quality metrics deteriorate materially, or if ABG fails to identify risks when implementing common practices among its various units. Although unlikely in the foreseeable future, we would consider raising ABG's ratings if the financial profile of its main subsidiaries strengthens significantly and the economic risk declines in the countries where ABG operates.	Bahrain	Paul-Henri Pruvost
Al Rajhi Bank (A+/Stable/A-1) The stable outlook reflects our expectation that ARB will retain its strong financial profile and leading commercial position in retail banking, despite increasing competition.We see limited room for further upgrades over the medium term. We could raise the ratings if the bank materially improves geographic and business diversification out of its domestic retail segment, if it further widens the funding mix to reduce maturity mismatches, and if the level of disclosure from key controlling shareholders improves, in turn enabling us to better assess their financial strength. The ratings may come under pressure if asset quality or capitalization weakens dramatically.	Saudi Arabia	Nicolas Hardy
Arab Banking Corp. B.S.C. (BBB+/Stable/A-2) The stable outlook reflects our opinion that the group will maintain its adequate asset quality and capitalization. Nevertheless, we believe that ABC will find it difficult to increase business diversification in the currently less favorable economic environment. We could lower the ratings if the group's funding and liquidity profile, core profitability, or capitalization shows signs of weakening. Although unlikely in the foreseeable future, we could raise the ratings if the group can significantly strengthen its profitability and funding profile, while limiting its risk appetite.	Bahrain	Goeksenin Karagoez
Arab National Bank (A/Stable/A-1)		

The stable outlook reflects our view that ANB will maintain its good revenue generating capability, despite the toughening economic environment in Saudi Arabia. We could raise the ratings if the bank makes significant and sustained progress in diversification, boosts capital ratios substantially, and displays materially improved asset quality indicators. We could consider a negative rating action if ANB's profitability erodes significantly, if capital ratios or asset quality deteriorate markedly, or the bank's approach toward geographic expansion is more aggressive than we currently expect.	Saudi Arabia	Nicolas Hardy
BMI Bank B.S.C. (BBB-/Negative/A-3) The negative outlook reflects our opinion that the bank will find it difficult to counteract weakening asset quality and profitability in the near term. Strong capitalization and commitment from BankMuscat, which owns 49% of BMI, are important mitigating rating factors. However, we are concerned about the difficulties that the more challenging operating environment poses to the bank's strategy. We could lower the ratings on the bank if its asset quality continues to deteriorate and reaches a level exceeding its loss absorption capacity or if its liquidity position deteriorates significantly. Although not likely, a weakening of the links with BankMuscat would also lead to a downgrade. The likelihood of a positive rating action in the foreseeable future appears limited. We could revise the outlook to stable if the bank can significantly improve its asset quality and demonstrate that it can achieve a satisfactory and sustainable financial performance.	Bahrain	Goeksenin Karagoez
BankMuscat S.A.O.G. (BBB+/Stable/A-2) The stable outlook balances the more challenging operating environment in Oman and pressure on funding with our expectations that BankMuscat will remain the dominant player in its home country. We expect the bank's ownership structure to remain broadly stable, with no weakening of links with the Omani government. We could consider a positive rating action if BankMuscat were to continue to improve its financial profile and maintain the cautious strategy adopted during 2009. Conversely, we could consider lowering the ratings if the banks suffers a material deterioration in capitalization, funding, or asset quality, or a loosening in its cross-border risk aversion.	Oman	Goeksenin Karagoez
Banque Saudi Fransi (A/Stable/A-1) The stable outlook reflects our expectation that BSF will protect its market position, continue to adapt its strategy to the changing economic environment, and conservatively manage its financial profile with resilient earnings capacity, adequate liquidity, and capitalization. The ratings are constrained by structural weaknesses in the Saudi economy and the bank's limited business and geographic diversification. We might consider lowering the ratings if concentration risks in the corporate lending book materialize and significantly erode the bank's financial profile, if BSF's appetite for risk increases materially, or quality of core earnings declines. Enhanced business diversification, along with better granularity of the loan portfolio and a material increase of core capital ratios, could prompt an upgrade of BSF.	Saudi Arabia	Nicolas Hardy
Burgan Bank (BBB+/Negative/A-2) The negative outlook reflects our views on Burgan's weakening asset quality, and its potential further impact on the bank's financial profile. We could revise the outlook to stable if, everything else being equal, Burgan significantly improves asset quality metrics and continues to cautiously manage its risk appetite in new lending. We could lower the ratings if capitalization or funding diminish faster than we currently expect, or if asset quality materially deteriorates further. We could also downgrade Burgan if we find that there is any higher risk appetite weakening Burgan's financial profile. We expect government funding support for Burgan to remain in place.	Kuwait	Paul-Henri Pruvost
Commercial Bank of Kuwait (BBB/Stable/A-2) The stable outlook reflects our view that CBK's capitalization and pre-provisions earning generation capacity will remain at the current level, offering a buffer against the expected continuation of asset quality deterioration. In addition, ongoing support from shareholders and authorities, through deposits, is likely to remain in place.We could lower the ratings on CBK if the deterioration in asset quality proves more severe than we expect, or if liquidity deteriorates significantly. We could raise the ratings if asset quality indicators improve materially and reliance on noncore deposits declines, reflecting a strengthening of CBK's business profile.	Kuwait	Nicolas Hardy
Commercial Bank of Qatar (The) (A-/Stable/A-2) The stable outlook balances what we see as CBQ's good domestic commercial position and satisfactory capitalization with the stabilization or slight deterioration we expect in the bank's asset quality and profitability. We would consider lowering the ratings if the bank's funding or liquidity profile weaken, or asset quality deteriorates significantly, or if the credit profile of the bank's associates weakens significantly. We see limited room for a positive rating action in the foreseeable future. In the longer term, we could raise the ratings if CBQ strengthens its funding and liquidity profile, reduces concentration risk, and demonstrates its ability to limit and control risks at its associates.	Qatar	Mohamed Damak
Doha Bank (A-/Stable/A-2) The stable outlook balances DB's good profitability and capitalization with the risks attached to its deteriorated operating environment and strong competition. We could lower the ratings if DB's concentration risk materializes on	Qatar	Mohamed Damak

either side of the balance sheet, which could undermine the bank's funding and liquidity profile or asset quality indicators and provisioning needs. On the other hand, we could raise the ratings if the bank improves the granularity of its loan portfolio and funding base, while keeping asset quality, profitability, and capitalization at current levels.		
Dubai Islamic Bank (BBB-/Negative/A-3) The negative outlook reflects the weakened operating environment and its expected impacts on DIB's financial profile. Under our base case scenario, we expect DIB's financial profile to remain in line with the current ratings. However, if the operating environment continues to worsen and the bank's financial profile, particularly asset quality and financial performance, are more affected than we expected, the ratings would come under downward pressure. On the other hand, we could revise the outlook to stable if operating environment pressure eases, the bank demonstrates a superior resilience to current market conditions, or if it improves its financial profile substantially.	United Arab Emirates	Paul Henri Pruvost
Gulf Bank (BBB-/Negative/A-3) The negative outlook reflects notably our ongoing concerns on about Gulf Bank's asset quality given the still uncertain economy. We could revise the outlook to stable if, all other things being equal, asset quality improves substantially and if we believe that the business franchise has not been impaired. We could lower the ratings if we perceive that asset quality or earnings capacity has worsened more than expected, thereby negatively affecting the bank's financial profile, or if the bank's capitalization or liquidity weakens substantially. We expect authorities' ongoing funding support to remain in place.	Kuwait	Paul Henri Pruvost
Gulf International Bank B.S.C. (BBB+/Stable/A-2) The stable outlook reflects our belief that GIB will continue to benefit from strong support from shareholders and maintain its improved asset quality and capitalization. We could lower the ratings if the bank fails to adjust its business model to the new, more difficult economic environment and maintain the adequate quality of its loan book and a satisfactory capitalization level. An upgrade would require a significant improvement in the bank's funding profile, the implementation of a business model that could generate adequate, sustainable profitability, and the maintenance of satisfactory asset quality and capitalization.	Bahrain	Goeksenin Karagoez
Gulf Investment Corporation G.S.C. (BB-/Stable/B) The stable outlook reflects our expectations that GIC's leverage will remain within the high 60%-65% range according to our loan-to-value calculations. In addition, we do not foresee a material improvement in the company's funding structure and expect it to remain skewed toward short-dated sources. We could take a positive rating action if GIC reduces leverage and addresses the short-term nature of its funding profile, all other things being equal. A weakening of the links between GIC and its shareholders, a deterioration in GIC's liquidity position, or an increase in leverage would result in a negative rating action.	Kuwait	Mohamed Damak
Kuwait Finance House (A-/Negative/A-2) The negative outlook mainly reflects our view that the deteriorating asset quality and the bank's rapid growth could weaken KFH's financial profile further. We would lower the ratings on the bank if the links with the Kuwaiti government loosen and if we reassess downward the likelihood of extraordinary support, if asset quality further deteriorates materially, or if capitalization continues to weaken. We would consider revising the outlook to stable if the bank displays resilient revenue generating capability and improved asset quality indicators, strengthens its capitalization, and enhances risk management capabilities.	Kuwait	Nicolas Hardy
Mashreqbank (BBB+/Negative/A-2) The negative outlook reflects Mashreq's deteriorating operating market and the effect we expect it will have on the bank's financial profile. Under our base-case scenario, we expect Mashreq's profile to remain adequate for the current ratings. However, the ratings would come under downward pressure if the operating environment continues to worsen, or if the bank's financial profile, particularly asset quality and financial performance, is more affected than we expect. On the other hand, we could revise the outlook to stable if operating market pressure eases, the bank demonstrates superior resilience to current business conditions, or if it substantially improves its financial profile.	United Arab Emirates	Mohamed Damak
National Bank of Abu Dhabi (A+/Stable/A-1) The stable outlook reflects our expectation that NBAD will maintain its leading commercial position and sound financial profile, with no significant change in its shareholding structure. The bank's dominant domestic position appears well secured, enabling it to counterbalance risks linked to the restricted playing field of the non-oil private sector and maintain satisfactory operating profitability, in our view. A change in ownership structure, leading to a weakening of the links between NBAD and the Abu Dhabi government, would negatively affect the ratings, as would a material deterioration in asset quality or capitalization. At this stage, we see ratings upside as unlikely owing to the prevailing difficulties in the GCC region's economies.	United Arab Emirates	Goeksenin Karagoez
National Bank of Kuwait S.A.K. (A+/Stable/A-1)		

The stable outlook reflects the resiliency of NBK's financial profile throughout economic cycles. Everything else being equal, we could lower the ratings if we perceive NBK's funding profile or asset quality is deteriorating significantly, or that the bank's growth and risk appetite has changed and is weakening the bank's financial profile. Although not our base case scenario, we could raise the ratings if we see that domestic economic risk is receding markedly and NBK's funding profile is strengthening.	Kuwait	Paul-Henri Pruvost
National Commercial Bank (The) (A+/Stable/A-1) The stable outlook reflects our view that NCB will maintain its strong domestic franchise and solid operating revenues. We could consider lowering the ratings if market risk proves to be higher than we assume, or if capital ratios or asset quality indicators deteriorate dramatically. We could raise the ratings if the bank is able to sustain a track record of strong and stable financial performance, while keeping capitalization and credit risk under control.	Saudi Arabia	Nicolas Hardy
Qatar National Bank (A+/Stable/A-1) The stable outlook reflects our expectation that QNB will retain its dominant commercial position and solid financial profile, with no major change in the shareholding structure. We see limited potential for an upgrade in the foreseeable future, given that our Banking Industry Country Risk Assessment (BICRA) places Qatar in Group 4; we don't expect to see a significant improvement in QNB's funding profile, which remains skewed toward short-dated instruments; and because QNB's track record of supervising newly acquired subsidiaries is short. The ratings could come under pressure if we were to perceive a weakening of QNB's links with the government; if QNB's financial performance, capital ratios, or asset quality were to deteriorate more than we anticipate; or if geographic expansion risks were to materialize.	Qatar	Mohamed Damak
Riyad Bank (A+/Stable/A-1) The stable outlook reflects our expectation that Riyad's financial profile and performance will prove resilient and capitalization will remain at strong levels. If earnings generation, capitalization, or asset quality were to deteriorate sharply, we might consider a downgrade. A sustained shift in risk appetite would also be a negative rating factor. Assuming the bank protects its current financial profile, the ratings could be raised under the combination of a better diversified business profile and structural improvements in the Saudi macroeconomic environment. These could include widespread economic diversification and liberalization, or the establishment of a stronger credit culture among domestic corporate borrowers. We see limited room for further upgrades over the medium term, however.	Saudi Arabia	Paul-Henri Pruvost
Samba Financial Group (A+/Stable/A-1) The stable outlook reflects our opinion that Samba will maintain its leading commercial position, solid capitalization, balanced risk profile, and solid operating revenues, with no major change in the shareholding structure. We see limited room for further upgrades over the medium term. Assuming the bank protects its current financial profile, we could raise the ratings if we see a combination of a better diversified business profile and structural improvements in the operating environment, including economic diversification and the establishment of a stronger credit culture among domestic corporate borrowers. The ratings would come under downward pressure if capital ratios deteriorate from present levels, operating revenue generation is materially diminished, asset quality deteriorates drastically, or international expansion becomes excessively aggressive.	Saudi Arabia	Nicolas Hardy
Saudi British Bank (The) (A/Stable/A-1) The stable outlook reflects our expectation that SABB will maintain its solid earnings stream and favorable market position, while continuing to benefit from the technical support of HSBC, which owns 40% of the bank. We could lower the ratings if the bank's asset quality continues to deteriorate, or if HSBC's multifaceted support appears to weaken. We could raise the ratings if SABB's financial profile improves materially, notably through a restored level of asset quality, increased revenue diversification, and strengthened capitalization. Ratings upside could also stem from a significant change in the shareholding structure that would strengthen the commitment of HSBC or the Saudi government to SABB.	Saudi Arabia	Nicolas Hardy
Saudi Investment Bank (The) (A-/Stable/A-2) The stable outlook reflects our view that SAIB's capitalization and preprovision earnings are likely to remain resilient through 2010. They should offer a sufficient buffer against potentially sustained pressure on asset quality from the currently less supportive economic environment and high concentration risks. Any further asset quality deterioration, which would in turn result in significant weakening in the bank's earnings and capitalization profile, could weigh negatively on the rating. On the other hand, we would view positively any reduction in its large concentration risk through a diversification of its lending book and funding, an improvement in asset quality metrics, and a sustainable strengthening and diversification in its earnings mix.	Saudi Arabia	Paul-Henri Pruvost
Sharjah Islamic Bank (BBB/Stable/A-2) The stable outlook balances SIB's good financial profile and our view of likely support from the Sharjah government with the deterioration in the bank's operating environment. We could lower the ratings if the bank's liquidity, financial performance, or capitalization decline materially. We could raise the ratings--assuming the operating environment recovers--if the bank successfully strengthens its business profile, including through diversifying and reducing	United Arab Emirates	Mohamed Damak

concentration risks, with no significant deterioration in capital and financial performance.

*Ratings are as of Sept. 1, 2010

Rating Activity

Table 3

Name of the Bank	To	From	Date of Rating Action	Rationale
Recent Rating/Outlook/CreditWatch Actions				
Bahrain				
Gulf Finance House	N/R	CC/Negative/--	July 5, 2010	We are withdrawing all the ratings on GFH at its request.
Gulf Finance House	CC/Negative/--	CCC-/Negative/--	July 5, 2010	The downgrade reflects our expectation that GFH is likely to restructure its debt soon because of its weakening liquidity and revenue generation. In our view, difficult operating conditions are hampering management's efforts to improve GFH's business and financial profile.
Gulf Finance House	CCC-/Negative/--	SD/--/SD	March 3, 2010	The rating action follows GFH's completion of the partial extension of maturity of a $100 million facility. The first tranche of this facility was a $50 million payment due March 3, 2010, with the remainder due on March 3, 2011. We understand that GFH has obtained consent for the partial extension from all lenders of the facility, which is set to be repaid in five installments over the next two years. Under our criteria, we consider GFH's maturity extension to be a "distressed exchange" and therefore tantamount to a default because the new maturity represents a change to the facility's originally scheduled payment terms. We subsequently reassessed GFH's creditworthiness by analyzing, among other things, GFH's new liability structure, cash flow projections, and its overall business model and strategy. On this basis, we raised the ratings on GFH to 'CCC-/C'.
Kuwait				
Al Ahli Bank of Kuwait	BBB+/Stable/A-2	BBB+/Negative/A-2	May 10, 2010	We believe that ABK has been and is likely to remain resilient to the change in its operating environment.
National Bank of Kuwait	A+/Stable/A-1	A+/Negative/A-1	May 10, 2010	We believe that NBK has been and is likely to remain resilient to the change in its operating environment.
Commercial Bank of Kuwait	BBB/Stable/A-2	A-/Negative/A-2	April 7, 2010	The rating action reflects our view that CBK's asset quality has materially deteriorated, and is likely to continue its negative trend in the coming quarters, weighing heavily on CBK's bottom line profitability. In addition, we believe that CBK's funding profile weakened in 2009 because of an increased reliance on noncore customer deposits.
Kuwait Finance House	A-/Watch Neg/A-2	A-/Negative/A-2	May 26, 2010	The rating action reflects our view that the material deterioration of asset quality indicators and reduced revenue generating capability--linked to the bad performance of equity and real estate markets--have negatively affected KFH's financial profile.
Kuwait Finance House	A-/Negative/A-2	A-/Watch Neg/A-2	June 29, 2010	The affirmation reflects our views about KFH's strong links and potential support from the State of Kuwait (AA-/Stable/A-1+), which we believe mitigate the bank's weakening asset quality and reduced revenue-generating capability. The Kuwaiti government is the bank's main shareholder, owning 48% through different institutions. The ratings on KFH reflect the bank's ownership structure, its leading domestic commercial position, and an adequate funding and liquidity profile.

Table 3

Recent Rating/Outlook/CreditWatch Actions (cont.)

Saudi Arabia				
Saudi Investment Bank	A-/Stable/A-2	A-/Negative/A-2	May 31, 2010	The stable outlook reflects our view that SAIB's capitalization and preprovision earnings are likely to remain resilient through 2010, offering a sufficient buffer against the possibly sustained pressure on asset quality owing to a less supportive economic environment and high concentration risks. We would take a negative view on any further asset quality deterioration that would result in a significant weakening in the bank's earnings and capitalization profile. On the other hand, we would consider positively a reduction of SAIB's large concentration risk through a diversification of its lending book and funding, an improvement in asset quality metrics, and a sustainable strengthening and diversification in its earnings mix.
Samba Financial Group	A+/Stable/A-1	A/Stable/A-1	May 31, 2010	The rating action reflects our view that Samba's financial profile has continued to strengthen, on support from a resilient financial performance, solid capitalization, and strong funding and liquidity indicators. We also consider that Samba benefits from a superior market position in Saudi Arabia and a supportive business mix between retail and corporate banking.
Al Rajhi Bank	A+/Stable/A-1	A/Stable/A-1	May 31, 2010	The rating action reflects our view that ARB's stand-alone credit profile has strengthened in the recent past, thanks to its unique market position in the Saudi retail market, increasingly diversified loan book, strong and resilient profitability, and growth strategy with solid capital ratios.
United Arab Emirates				
Mashreqbank	BBB+/Negative/A-2	BBB/Watch Neg/A-2	April 7, 2010	We raised to two notches from one notch the uplift we factor in to the long-term rating on Mashreqbank, which led to the raising of the long-term counterparty credit ratings on the bank to 'BBB+'. The outlook is negative, due to the pressure on this bank's financial profile from what we view as a difficult operating environment.
Dubai Islamic Bank	BBB-/Negative/A-3	BBB-/Watch Neg/A-3	April 7, 2010	The outlook is negative, due to the pressure on these banks' financial profile from what we view as a difficult operating environment.
Abu Dhabi Commercial Bank	A/Negative/A-1	A/Watch Neg/A-1	April 7, 2010	The outlook is negative, reflecting our view of the ongoing pressure on ADCB's asset quality and capitalization.

Contact Information

Table 4

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Related Criteria And Research

The Economic Slowdown Reveals A Growing Divergence In Credit Quality Among Gulf Banks, Feb. 22, 2010

Gulf Investment Companies Face The Need To Rethink Their Business Models And Financial Policies, June 28, 2010

818173 | 300661093

FI Criteria: Bank Rating Analysis Methodology Profile, March 18, 2004

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