

BANKING

Optimism returns to Islamic banks

MEED survey shows sector is still growing and sharia-compliant institutions are well placed for recovery

For most Islamic banks, today's market conditions are the toughest they have ever had to face. In the GCC Islamic banking sector – an industry dominated by banks that are less than a decade old – institutions have been sucked into the turbulence of a global recession. But despite this, the banks are still growing, albeit at a slower pace than one year ago, and optimism is slowly returning.

"We believe the worst may be over," says Naveed Khan, managing director of ABC Islamic Bank, a wholly owned subsidiary of Bahrain's Arab Banking Corporation.

However, Khan adds that significant new lending activity in the sector is unlikely to get under way until the start of 2010 at the earliest.

Media reports on 19 April that a large sharia-compliant bank, Al-Istakhlaf, will be launched this year in Bahrain, with up to \$7bn in investment, add to the sense of confidence.

But is this renewed optimism justified? Figures from MEED's ranking of the 50 largest GCC Islamic banks (see table, page 20) offer some support. The top 50 Gulf banks now control assets worth more than \$229bn, almost one quarter of the estimated \$1 trillion held by the entire global Islamic banking sector. On average, the value of GCC Islamic banks' assets has increased by 35 per cent over the past year.

Alongside this, revenues have increased by 22 per cent on average.

Restricting investments

But banks are having to work much harder to make profits, which are growing far more slowly than assets or revenues. On average, GCC Islamic banks' net profits have increased by 6 per cent over the past 12 months, but five banks in the top 50 have made a loss and 26 have suffered falls in profits.

While it is widely believed that Islamic banks have fared better than conventional banks in the current crisis, they are having problems. "The Islamic banking sector felt for a while in the summer [of 2008] that it was immune [to the global financial crisis]," says Neil Miller, a partner at UK law firm Norton Rose. "But that has rapidly changed."

"Is Islamic banking the panacea? Absolutely not," says Anouar Hassoune, vice-president and

TOP 50 ISLAMIC BANKS BY COUNTRY

Bahrain	22
UAE	9
Kuwait	8
Qatar	6
Saudi Arabia	5

Source: MEED

AVERAGE ANNUAL GROWTH OF TOP 50 (%)

Assets	35
Revenues	22
Profits	6

Source: MEED

"A crisis is a curse for most people, but it can be a blessing for those able to react to it"

Anouar Hassoune, Moody's Investors Service

senior credit officer at ratings agency Moody's Investors Service. "Islamic banking is part of the global financial industry. The impact [of the credit crunch] is not direct, it is indirect."

According to Hassoune, investment banks are most exposed to the global turmoil. He describes them as "the Achilles' heel of the Islamic banks", which without retail deposits to fund their investment activities are forced to borrow money on wholesale markets, which are increasingly expensive and restricted.

The value of Islamic bond (sukuk) issues fell dramatically in 2008, adding to the pressure. A record \$50bn worth of sukuk were expected to be issued in the region in 2008, but the actual amount was closer to \$15bn. As raising money has been harder and banks have had to pay more to do so, their margins have fallen and so have the returns they can offer customers.

Highlighting the difficulties, Sico Investment Bank issued its first report on fellow Bahrain bank Global Finance House in mid-April, saying the Islamic investment bank's business model "has become challenged", with the investors it relies on now largely unwilling or unable to fund new projects.



Growth: Sharia-compliant financial institutions such as Dubai

Retail banks, with their customer deposit base to rely on, appear far more stable in comparison. Indeed, the sense that Islamic banks were less exposed to sub-prime toxic assets has made the job of attracting deposits easier, as wary investors opt to put their money in the least affected parts of the markets. "A crisis is a curse for most people, but it can be a blessing for those able to react to it," says Hassoune.

The reliance on just a few asset classes is at the root of the problems the investment banking sector in particular has suffered. While their sharia principles meant they had to avoid the hedge funds and collateralised debt obligations that led to the humbling of some of Wall Street's most prestigious banking names, plenty of other avenues are also closed off to Islamic banks. The limited range of investment



“More than 100 large hotels will open in the region in the next four years”

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Islamic Bank, the third largest in the GCC, are continuing to expand despite the global financial crisis

options open to them, requiring them to invest in asset-backed funds, means they are heavily exposed to a few segments of the market that have been among the worst performing sectors of the Gulf economies, such as real estate.

Increasing competition

A shortage of skilled staff and a lack of regulation has been seen as the major difficulty in the expansion of Islamic banking, but for now these are secondary issues.

“The shortage of skills is a generic issue to the expansion of Islamic banking, but at the moment it is the tough economic environment that is clouding out all other considerations,” says Khan.

As a result, a need to diversify, both in terms of their range of banking activities and their

geographic reach, is one of the key pressures on Islamic banks.

Even as they seek new opportunities, they are finding that competition is getting tougher. There are 350 Islamic banks around the world, most of which were set up over the past decade. “Islamic finance is much more competitive today than it was six months ago,” says Richard Thomas, chairman of Gatehouse Bank, a UK-based Islamic banking subsidiary of Kuwait’s The Securities House.

Competition is also coming from conventional banks promoting their own sharia-compliant products. Saudi Arabia’s National Commercial Bank, for example, operates 275 branches across the kingdom dedicated exclusively to Islamic banking services. Many others offer some Islamic banking services to their

customers, without operating as a wholly Islamic institution.

“There is a [competitive] threat from conventional banks, but I think the greatest threat is offering products that are not truly Islamic,” says Oliver Agha, a partner at UAE-based sharia-compliant law firm Agha & Shamsi.

Agha says many banks are offering products that may turn out to be not fully sharia-compliant. “My sense is that there appear to be deficiencies in how some of these products are done,” he adds.

Seizing opportunities

Nonetheless, the wholly Islamic banks need to grow if they are to make the most of the opportunities in the market. Their lack of size makes it difficult for them to take advantage of the downturn among conventional banks. “If a large corporate comes to me wanting \$200-300m trade finance, I would have to syndicate it; most Islamic banks would,” says Thomas.

“I do think Islamic banks will step in and underwrite bigger ticket items as time goes by,” says Agha. “[But] the market is not going to have the appetite to swallow the larger project finance deals.”

Despite the small size of the Islamic banking sector, few people are expecting significant merger activity this year, and if it does happen, it may be conventional banks moving into the market rather than rivals buying each other up. “Conventional, big banks with spending power are on the prowl for acquiring small Islamic banks in certain geographic markets to complement their conventional product offerings,” says Khan.

Already, some large global players have sharia banking subsidiaries. The US’ Citibank, for example, set up Citi Islamic Investment Bank in 1996, although it remains relatively small, with \$27.7m in assets and net profits of just \$1.6m in 2008.

The largest Islamic institution in the region, Saudi Arabia’s Al-Rajhi Bank, offers further grounds for optimism in its results for the first quarter of this year. In mid-April, Al-Rajhi reported net profits for the first quarter of the year of SR1.73bn (\$460m), a 22 per cent improvement on the same period in 2008.

TOP 50 GCC ISLAMIC BANKS RANKED BY ASSETS

Rank	Bank	Country	Assets at 31 December 2008 (\$m)	2008 revenues (\$m)	2008 net profit (\$m)	Assets at 31 December 2007 (\$m)	2007 rank
1	Al-Rajhi Bank	Saudi Arabia	44,038.6	2,823.8	1,742.2	33,480.3	1
2	Kuwait Finance House	Kuwait	38,168.8	3,203.1	6,322.2	32,183.2	2
3	Dubai Islamic Bank	UAE	23,150.0	1,509.6	471.1	22,972.0	3
4	Abu Dhabi Islamic Bank*	UAE	13,371.7	na	200.6	11,993.1	4
5	Qatar Islamic Bank	Qatar	9,211.3	701.5	451.1	5,862.1	5
6	Bank Al-Jazira**	Saudi Arabia	7,348.2	303.6	59.4	5,781.0	6
7	Emirates Islamic Bank	UAE	7,078.6	408.4	109.2	4,616.7	7
8	Noor Islamic Bank	UAE	5,989.6	na	na	na	na
9	Ithmaar Bank	Bahrain	5,380.4	465.8	85.2	4,075.8	9
10	Arcapita	Bahrain	5,137.4	648.6	362.2	3,805.5	10
11	CIMB Islamic Investment House*	Bahrain	4,816.4	42.2	15.5	2,697.1	17
12	Dubai Bank**	UAE	4,290.5	106.1	63.2	2,972.9	12
13	Amlak*	UAE	4,287.6	261.7	120.9	2,577.0	18
14	Bank Albilad	Saudi Arabia	4,286.1	233.5	33.4	4,459.8	8
15	Sharjah Islamic Bank	UAE	4,219.9	256.0	63.1	2,963.7	13
16	Alinma Bank	Saudi Arabia	4,153.8	90.4	104.1	na	na
17	Kuwait International Bank	Kuwait	3,919.8	348.7	71.7	3,467.3	11
18	Masraf al-Rayan*	Qatar	3,648.7	na	192.5	2,800.0	14
19	QNB Al-Islami	Qatar	3,569.9	na	91.0	1,978.2	22
20	Qatar International Islamic Bank	Qatar	3,526.7	256.1	193.8	2,734.2	15
21	Gulf Finance House	Bahrain	3,485.1	617.6	291.9	2,245.1	20
22	Tamweel*	UAE	3,376.0	283.3	156.0	2,318.4	19
23	Bank Boubayan**	Kuwait	3,067.1	217.2	7.2	2,728.6	16
24	Shamil Bank	Bahrain	2,884.9	66.8	22.8	2,045.7	21
25	Bahrain Islamic Bank	Bahrain	2,318.2	147.6	59.2	1,754.6	23
26	Badr Al-Islami Banking	UAE	1,797.1	62.3		638.6	30
27	Al-Salam Bank	Bahrain	1,470.7	131.5	67.8	1,058.9	25
28	ABC Islamic Bank	Bahrain	1,440.0	33.8	25.6	1,365.0	24
29	Khaleeji Commercial Bank	Bahrain	1,233.4	126.5	72.4	718.9	28
30	The Securities House	Kuwait	1,142.8	80.5	-87.0	1,035.0	27
31	Al Safa Islamic Banking	Qatar	1,116.4	57.8	19.4	466.7	35
32	First Energy Bank	Bahrain	1,021.2	17.0	0.04	na	na
33	Al Baraka Islamic Bank	Bahrain	1,001.5	28.5	2.5	1,038.8	26
34	Unicorn Investment Bank	Bahrain	978.8	230.6	35.0	488.4	34
35	Qinvest***	Qatar	934.2	102.6	67	na	na
36	The International Investment Group*	Kuwait	655.3	53.6	33.3	634.6	31
37	Al-Madar Finance & Investment*	Kuwait	638.0	27.5	0.6	624.9	33
38	Sukouk Holding Company*	Kuwait	582.4	7.3	16.4	632.9	32
39	The International Investor*	Kuwait	543.4	39.1	-38.3	691.9	29
40	Global Banking Corporation	Bahrain	455.9	53.2	21.2	236.2	39
41	Seera Investment Bank	Bahrain	376.7	18.2	-13.8	383.4	36
42	Capinvest	Bahrain	259.6	32.6	9.4	324.2	37
43	Venture Capital Bank	Bahrain	243.0	82.0	47.0	222.0	40
44	Jadwa Investment	Saudi Arabia	na	na	na	212.9	41
45	International Investment Bank	Bahrain	218.7	35.0	13.5	257.3	38
46	Elaf Bank	Bahrain	193.0	7.4	2.3	205.6	42
47	First Leasing Bank	Bahrain	179.4	9.5	3.0	102.3	45
48	Gulf One Investment Bank*	Bahrain	160.2	12.1	6.0	116.2	44
49	First Investment Bank	Bahrain	117.1	5.6	-3.7	na	na
50	Investors Bank	Bahrain	95.0	5.2	-34.9	137.1	43

*2008 figures cover period to 30 September **2008 figures cover period to 30 June *** Qinvest figures cover 11 months to 31 March 2008. na=not available. Source: MEED


Abdullah Sulaiman al-Rajhi, chief executive officer of the bank, attributes the performance to the bank's diversified financing and investment portfolio, particularly in relation to corporate customers. This will offer further support to the conviction among many Islamic bankers that the sector will come out of the downturn more quickly than its conventional banking peers. "We are going to see Islamic finance come out much quicker from the

financial crisis than conventional banking," says Thomas.

The nature of any recovery is uncertain, but Khan says profits may pick up before assets start rising quickly. "There will be little asset growth [in 2009]," he says. "However, income growth may increase much faster as credit spreads have widened considerably."

The recent trend for Gulf governments to launch sovereign bond issues—including

Bahrain's promise to issue a sukuk – should offer further opportunities. But the greatest problems are likely to come with large refinancing deals for projects that have yet to be completed and are thus not generating any revenues.

If the industry can maintain growth in this environment, it bodes well for its prospects when the market does fully recover, whether in 2010 or beyond. 

Dominic Dudley