

Chairman's Statement

Dear Shareholders,

On behalf of the Board of Directors, it gives me great pleasure to present the 27th Consolidated Financial Statements of United Gulf Bank B.S.C. for the financial year ended 31 December 2006.

The Bank had another year of stellar performance. I am pleased that the confidence of our shareholders has again been rewarded. In my statement to you last year, I said the Bank was well placed for future growth and our 2006 results have redeemed my statement. Our record performance in 2005 has now become overshadowed by another record year in 2006, the fourth consecutive year of remarkable performance. Net income of US\$ 101.5 million posted in 2006 was higher by a very healthy 25.3 per cent over the US\$ 81 million recorded in 2005, despite a significant correction witnessed in GCC stock markets during 2006. The results exceeded the 2006 forecast of US\$ 85 million we presented at KIPCO's Shafafiyah Investors' Forum in May 2006. Through this, the earning depth, financial strength, flexibility and diversity of the Bank's quality assets have been reaffirmed.

Earnings per share at US 12.81 cents in 2006 was 21.5 per cent higher than the US 10.54 cents in 2005. The return on average equity was 23.5 per cent in 2006, moderately lower than the 24.7 per cent achieved in 2005 largely as a result of a 30 per cent increase in the shareholders' equity in 2006. However, the Bank's financial strength improved, underpinned by consolidated BIS ratio of more than 26 per cent against 25.8 per cent in 2005. The Bank's ratio of liquid assets to total assets stood at 37 per cent at the end of 2006. Operating cost to operating income increased due to expanding operations to 30.4 percent in 2006 from 27 per cent in 2005 but still much below the average in the industry. This reflects prudent cost management and efficient utilization of resources.

Strong GCC economies: stock markets volatile but expanding

2006 was a year of rapid growth, low inflation, significant external surpluses and robust public finances for the GCC economies. For the fourth successive year, nominal GDP in the GCC has grown at double digit rates. The GCC economies have been transformed into a dynamic emerging market. Real growth in 2006 has been impressive at an average rate of about 6 per cent and has outstripped the increase in population with real per capita GDP in each member state reaching new highs.

GCC stock markets, however, have experienced significant correction during the year with share value declining between 52.5 per cent on the Saudi market and 12.7 per cent on the Kuwait market. The exceptions were the markets in Oman and Bahrain with the index gain of 14.5 per cent and 1 per cent respectively. Notwithstanding their poor performance in 2006, regional stock markets have expanded and matured significantly over the past five years. These markets have been witnessing increasing numbers of new listings which is good for overall market capitalization. A total of 633 securities were listed on GCC stock markets in 2006, against 579 in 2005. Cumulative value of shares traded amounted to US\$ 1.61 trillion in 2006 against US\$ 1.37 trillion traded in 2005. Private equity market has also gained prominence in GCC. It is estimated that private equity funds raised US\$ 10 billion in the GCC during 2006 against US\$ 5.7 billion in 2005.

UGB's performance continues to impress

Our momentum of growth in net income that began in 2001 continued in 2006. After reaching an all time high of US\$ 81 million net income in 2005, last year we achieved another record of US\$ 101.5 million - a remarkable 25.3 per cent increase over the year.

Total revenues also jumped to almost a quarter of a billion dollars in 2006 to US\$ 241.8 million. This was a 21.7 per cent growth over US\$ 198.8 million achieved in 2005. This growth was broad based coming from 14 business streams including all asset classes and investment banking activities. Investment income shot up

by 23.4 per cent to US\$ 96.5 million over US\$ 78.2 million in 2005 with strong performance in 'investments held for trading', and the gain recorded on the sale of associated companies. Investment in the European emerging market and alternative investments made a marked contribution. Fees and Commissions income also increased 18.6 per cent to US\$ 54.5 million from US\$ 45.9 million in 2005. This growth was achieved largely from our wealth management activities, but our commercial bank in Algeria also increased its contribution to this figure. Our share of profit in associated companies increased 8 per cent to US\$ 53.5 million in 2006 from US\$ 49.6 million in 2005.

KAMCO - our asset management subsidiary - posted a net profit of US\$ 54.7 million in 2006, considerably lower than US\$ 85.8 million in 2005. This was the result of the downturn in the Kuwaiti market. Tunis International Bank, our commercial banking subsidiary in Tunis posted a significant 45.1 per cent growth in its net income to US\$ 11.9 million in 2006 from US\$ 8.2 million in 2005. Algeria Gulf Bank, a commercial bank established in Algeria in March 2004, is steadily gaining its market share in Algeria. In 2006, it posted a net profit of US\$ 4.7 million against US\$ 1.2 million in 2005. Jordan Kuwait Bank, our banking affiliate in Jordan, posted a robust 53.6 per cent growth in net profit to a record amount of US\$ 55.3 million in 2006 over US\$ 36 million in 2005. The Bank of Baghdad, acquired in October 2005, has contributed US\$ 1.86 million in 2006, up from US\$ 0.38 million in 2005.

Hidden value in listed core investments

Recurring revenues from our core investment in subsidiaries and associates, fees income from asset management activities and dividends remained almost constant in dollar value terms and represented 54 per cent of our total revenues in 2006. Besides their significant impact on the Bank's recurring revenues, the publicly listed companies in the Bank's core investment portfolio offer significant hidden values which are not accounted for on the Bank's balance sheet.

The market value of Bank's shares in five of our listed subsidiaries and associates was US\$ 895.9 million as of 31 December 2006 against a carrying cost of US\$ 624.1 million. This represents US\$ 271.8 million excess in hidden value or 44 per cent of book cost. This provides a vital cushion of financial strength to the Bank's balance sheet, to its liquidity, to its equity and a consistency and strength to its revenue base.

During the year the Bank realized US\$ 13 million through the sale of a small portion (3.3 per cent) of its equity stake in Jordan Kuwait Bank (JKB). The measure was largely aimed at testing the liquidity in the market. The shares were later repurchased to maintain the equity stake in JKB at 44 per cent. One of the Bank's direct investments was revalued in 2007 adding US\$ 42.1 million (111 per cent of book cost) in fair value reserves to the Bank's equity. This investment is earmarked for realization during 2007.

Sadly, investors have continued to overlook the extent of hidden value in our balance sheet. Thus the Bank's shares on the Bahrain Stock Market slipped to 365 Bahraini fils at the year end in 2006 from 430 Bahraini fils at the beginning of the year. Market capitalization stood at US\$ 776.6 million down from US\$ 913 million at the year end in 2005.

Pan-Arab universal banking platform

As a Pan-Arab universal banking services provider, the Bank continues to sharpen its well defined strategy of expanding its commercial and investment banking network throughout the Middle East and North Africa region (MENA). Incremental revenues have and will continue to be derived from our presence in markets such as Algeria, Iraq and Syria. These operations will complement revenues from our investment banking and asset management activities and our growing proprietary and alternative investment portfolios.

Algeria Gulf Bank will open a minimum of six new branches in 2007. Tunis International Bank's Representative Office in Tripoli, Libya has been operational since May 2006. UGB took over management of its associate, Bank of Baghdad, from 1 March 2006 and is restructuring the business strategy, the

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management and business team there. Syria Gulf Bank had a successful IPO during the year with the offer being over-subscribed by two and a half times. The company is on course to open for business in the first quarter in 2007 and has decided to double its paid-up capital to US\$ 60 million so that it can manage the new capital requirement being introduced by the Central Bank of Syria.

United Gulf Financial Services Company in Qatar completed its infrastructure and is set to commence operations in the first quarter in 2007. Our joint investment venture in Tunis - MAC United Gulf - and Royal Capital in Abu Dhabi are developing on schedule. In Kuwait, the Bank took a 21.32 per cent equity stake in founding North Africa Holding Company, a closed Kuwaiti company capitalized at KD 50 million (US\$ 173 million). The company's primary objective is the investment in private equity markets in North Africa. The Bank had in 2005 taken a 26.55 per cent stake in Manafae Investment Company, a Sharia compliant asset management company in Kuwait, capitalized at KD 20 million (US\$ 69 million). The company commenced its operations during 2006. With all these financial units, UGB's financial services has expanded its banking footprint to 12 countries in the MENA Region.

Asset growth and BIS ratio

Several new investments were made in promising new companies with additional investments in existing operations. New products and alternative investments have been added in an effort to diversify and expand the earning base. Total assets thus increased to US\$ 663.8 million during 2006 to an all time high of US\$ 2.35 billion at the year end.

The expansion in the earning assets accompanied the increase in the regulatory capital, thus maintaining the financial strength of the Bank. During 2006, the Bank raised US\$ 100 million in its debut Subordinated Step-Up Floating Rate Notes due 2016 (Lower Tier 2) positioning itself proactively for Basel II implementation in 2008.

Shareholders' equity increased 30 per cent to US\$ 489.2 million as at 31 December 2006 from US\$ 376.3 million at the year end in 2005. Together with the minority interest and LT2 the regulatory capital base stood at US\$ 601.9 million as at 31 December 2006 providing a consolidated BIS ratio of 28.3 per cent against 25.8 per cent as at 31 December 2005 despite 39.4 per cent growth in total assets. UGB's solo BIS stood around 15.8 per cent, a marked improvement over 10.7 per cent in 2005.

The Bank now stands on a strong earning and capital base with its market profile considerably improved. During the year the Bank obtained a rating boost with Capital Intelligence upgrading its rating to BBB+/A2 and Moody's assigning a first time investment grade rating of Baa3/Prime-3. The investors in the Bank's US\$ 60 million bond extended the maturity by two years to 2008. Treasury lines increased to US\$ 1.1 billion in 2006 from US\$ 792 million in 2005.

Future outlook

The earning assets have increased during 2006 without any compromise on the financial strength of the balance sheet. Thus 2007 promises to be another good year of progress bolstered by the growth in our key business activities. The long term prospect for the Bank is encouraging as we anticipate further gains from our global portfolios as well as distributions / realizations from telecommunications and other mature regional investments. Contributions from our growing financial services network in emerging Arab countries are also expected to increase significantly.

Corporate governance

The Bank is subject to the corporate governance standards of the Central Bank of Bahrain (CBB). These standards foster a culture within Bahraini banks of proactive boards of directors that are accountable and responsible for the affairs and performance of their banks.

The licensing regime of the banks in Bahrain have been modified and divided into two main categories, defined by their regulated activities. United Gulf Bank has now been licenced afresh as a Conventional Wholesale Bank.

During 2006, the Board held six scheduled and four unscheduled meetings to consider various business proposals and financial strategic actions.

The Board Audit Committee met three times during the year to consider and evaluate various reports from the Internal Audit Department. This is an ongoing process of assuring controls and quality as well as compliance parameters of your Bank.

Other committees that oversee various functions of the Bank are the Management Committee, Asset & Liability Committee, Investment Committee, Board Executive Committee, Insider Trading Committee and Risk and Compliance Committee.

As of 31 December 2006, Directors own 636,000 shares (no change) and Executive/Senior Management 793,480 (2005: 41,000) shares of the Bank, the latter largely through exercise of their stock options. Executive/Senior Management and other staff have been granted 27.7 million share options under the Bank's Employee Stock Option Plan as approved at the EGM held on 24 March 2004.

Dividend and donations

In view of the excellent results achieved in 2006, I am pleased to report that the Board has recommended to the Annual General Meeting the payment of a 34.6 per cent in cash dividend (US 8.65 cents per share) (2005: 27.5 per cent or US 6.875 cents per share).

Your Board has also recommended to the Annual General Meeting an allocation of US\$ 500,000 for its on-going charitable works in Bahrain (2005: US\$ 500,000) which is administrated under the supervision of Masharee Al-Khair Charity, an organization formed to organize and focus the charitable activities of KIPCO Group companies. The Program also covers a scholarship scheme for academically gifted and deserving children of the Bank's employees.

Gratitude and Thanks

On behalf of the Board, I extend our gratitude and best wishes to His Majesty King Hamad Bin Isa Al Khalifa; the Prime Minister, H H Sheikh Khalifa Bin Salman Al Khalifa and to the Crown Prince and Commander in Chief of the Bahrain Defense Force, H H Sheikh Salman Bin Hamad Al Khalifa. Our thanks and gratitude to the Central Bank of Bahrain and the Capital Markets Directorate for its continuous support and understanding and to the Ministry of Commerce and to the Stock Exchanges in Bahrain and Kuwait for their encouragement.

I thank our shareholders and all stakeholders for their on-going support and extend my personal appreciation and thanks to our management team and staff who have shown commitment and loyalty in contributing to our outstanding successes and achievements.

Faisal Hamad Al-Ayyar

Chairman