

# Chairman's Statement



**Faisal Al Ayyar**  
Chairman

## Dear Shareholders

On behalf of the Board of Directors, it gives me great pleasure to present the 28th Consolidated Financial Statements of United Gulf Bank BSC (UGB) for the financial year ended 31 December 2007.

It was a remarkable year for the Bank. Another record set in profitability. Our focus over the past several years has been to build, expand and grow our financial services network in the MENA region, astutely build our assets book in direct investments and trading equities and manage our exits at opportune times. We did make certain very rewarding exits during the year under the lead of our Parent Company. The result of exceptional gains on these exits combined with sustained organic growth in our wealth management and financial services businesses and gains in our trading books has been another superb year in 2007. Net profit at US\$ 220.9 million in 2007 is yet another historical best, a stunning 117.7 percent rise over US\$ 101.5 million recorded, as the then best year, in 2006. The result posted in 2007 again exceeded our forecast of US\$ 195 million made at KIPCO's Shafafiyah Investors' Forum in May 2007. Even the normalised profit of the Bank at US\$ 111.5 million recorded a solid increase of 37.5 percent over the comparable figure of US\$ 81.1 million in 2006. Our achievement has a special significance as the second half of 2007 witnessed significant turmoil in global financial markets driven by rapidly mounting defaults in subprime housing loans in the USA which led to a deterioration in the global lending environment. This was coupled with rising energy and commodity prices and a declining dollar. Some very prime banking giants in the global financial industry had to take multi billion dollar losses on their debt holdings and looked to some leading global investors to bail them out through additional capital injection.

Earnings per share at US 27.30 cents in 2007 was 113 percent higher than the US 12.81 cents in 2006. The return on average equity was 38.4 percent in 2007, posting an impressive increase over 23.5 percent achieved in 2006, despite an expansion in the Bank's average capital base. The Bank's financial strength continued to be solid, underpinned by a consolidated BIS ratio of 33 percent against 28.3 percent in 2006. Operating cost to operating income decreased to 20.9 percent, from 30.4 percent in 2006 despite expanding operations. This compares favourably with the average in the industry and reflects a growing revenue base outstripping the expanding operating cost.

## GCC markets post strong gains

The GCC markets have benefited from rising oil prices, increasing liquidity and improving corporate earnings. GCC economies have expanded at an annual average real rate of seven percent. Soaring oil prices boosted hydrocarbon revenues contributing to large fiscal and external surpluses. GCC fiscal and current account surpluses increased to 23 percent and 27 percent of GDP respectively in 2006, despite sharp increases in fiscal spending and import payments. GCC nominal GDP in 2007 is expected to exceed US\$ 790 billion. The composition of growth is shifting, with the non-oil sector now becoming the major factor. Despite rising oil prices, the non-oil sector's contribution to real GDP growth increased from 49 percent in 2003 to 84 percent in 2006. Underpinning the structural shift is a substantial increase in domestic investment across the GCC. Investment projects under implementation in GCC countries are projected to be worth at least US\$ 800 billion in the next five years, with more than 75 percent of that amount in the non-hydrocarbon sector.

Subsequent to the major correction in 2006, all GCC equity markets posted impressive gains in 2007 and almost escaped the impact of the financial crisis in the subprime housing loans. All equity markets in the region had strong growth with Oman and Abu Dhabi leading the trend with 61.9 percent and 51.7 percent rise in their respective MSM30 and ADI Indices. The GCC strong economic fundamentals, high liquidity and commercial banks' low aggregate exposure to the US subprime instruments helped contain the impact of the global credit meltdown.

## UGB extends its spectacular performance

The Bank has continued with its impressive growth in 2007, the fifth consecutive year of consistent record breaking journey into the future.

Total revenues of US\$ 441.3 million posted in 2007 were at the record high, an 82.5 percent jump over US\$ 241.8 million in 2006. The year saw exceptional gains of US\$ 109.4 million from the sale of telecommunication assets, and from the sale of investments in United Fisheries of Kuwait and United Projects for Aviation Services Company. The results also include healthy gains from organic growth in our wealth management and financial service sectors with KAMCO, Algeria Gulf Bank, Bank of Baghdad, Jordan Kuwait Bank and Tunis International Bank posting significant gains in their respective businesses. Investment income at US\$ 200.1 million was 107.4 percent higher in 2007 than US\$ 96.5 million in 2006 partly influenced by exceptional gains on the three exits mentioned earlier and partly due to an increase of US\$ 45.7 million in gains on investments held for trading and an increase of US\$ 6.5 million in dividend income.

Besides the stellar performance on the investment portfolio, the Bank's income from fees and commissions shot up 49.5 percent to US\$ 81.4 million in 2007 from US\$ 54.5 million in 2006 and share of profit from associated companies registered a phenomenal 99.7 percent growth to US\$ 106.9 million from US\$ 53.5 million in 2006.

As our financial services network will continue to consolidate its position in respective markets, this sector will increasingly contribute to the Bank's revenues.

Operating income increased 104.7 percent to US\$ 359.7 million in 2007 from US\$ 175.8 million in 2006 with operating expenses increasing 41 percent to US\$ 75.3 million over US\$ 53.4 million in 2006. Higher operating expenses were the result of an expansion in the human resource base, improved employee compensation and expansion in the financial network. It is satisfying that the operating expenses to operating income ratio dropped significantly to 20.9 percent in 2007 from 30.4 percent in 2006 as increase in income outstripped growth in operating expenses.

### Expanding footprint of financial network

The Bank has strategic investments in a number of financial and non-financial subsidiaries and associates. The increasing importance of the financial network and in the future growth of the Bank is fully appreciated by your Board.

As a MENA 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. Incremental revenues have and will continue to be derived from our growing financial services

operations in the MENA region. These operations will complement revenues from our investment banking and asset management activities and our growing proprietary and alternative investment portfolios.

In the wealth and asset management business, KIPCO Asset Management Company (KAMCO) is making a significant impact. KAMCO posted a 148.5 percent growth in its net profit in 2007 to US\$ 135.9 million over US\$ 54.6 million in 2006 with income from fees and commissions posting a stellar 45.1 percent growth on the back of increasing activities in the wealth management and corporate advisory services. Assets under management at KAMCO expanded to US\$ 8.1 billion in 2007 increasing 25.1 percent from US\$ 6.5 billion in 2006. KAMCO's equity research has improved its coverage and its readership.

The portfolio management business at United Gulf Financial Services (UGFS), Doha, established under the auspices of the Qatar Financial Center, commenced its operations in the first quarter of 2007 and is slowly picking up as UGFS strengthened its resources base. UGFS, recorded an operating loss of US\$ 1.6 million in its start up year. Operating in one of the fastest growing economies in the GCC, your Board is confident of UGFS' success in the coming years which is positioned well to contribute to UGB's future success.

Algeria Gulf Bank (AGB) is expanding its branch footprint, having obtained the Central Bank's approval to open five new branches and is scheduled to open five more branches during 2008. AGB has increased its business with total assets increasing to US\$ 189.8 million as of year end in 2007 from US\$ 141.5 million in 2006. Net income for the year posted an impressive growth of 63.9 percent to US\$ 7.8 million from US\$ 4.7 million in 2006.

Bank of Baghdad (BoB), one of the largest private commercial banks in Iraq, is making steady progress after UGB took over the management advisory role of the bank in March 2006 and BoB is positioning itself as one of the leading financial service providers in Iraq. In October 2007, UGB increased its ownership in BoB to 45 percent from the initial level of 25 percent reflecting your Board's confidence in the future prospect of the bank. In 2007 BoB recorded an exceptional growth of 4.7 times in its net income to IQD 16.79 billion (US\$ 13.8 million) from IQD 3.6 billion (US\$ 2.7 million) in 2006. BoB is expanding its branch network in Northern Iraq which enjoys relatively better political stability.

In Jordan, Jordan Kuwait Bank (JKB) has successfully evolved into a medium sized player in the Jordanian banking system and is an important strategic asset for UGB. It recorded a strong year with total assets

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expanding to JOD 2.0 billion (US\$ 2.85 billion) as of year end in 2007 over JOD 1.65 billion (US\$ 2.33 billion) in 2006. Net income significantly increased 13.4 percent to JOD 44.4 million (US\$ 62.6 million) in 2007 from JOD 39.1 million (US\$ 55.2 million) in 2006.

In Syria, Syria Gulf Bank (SGB), which was licensed in April 2006, completed its regulatory requirements and successful public offering of its 26 percent shares in September 2006. The issue was two and a half times oversubscribed. A year later in September 2007, the bank successfully raised the paid up capital from US\$ 30 million to US\$ 60 million. The bank was formally opened for business on 13 June 2007 at its Head Office branch in Damascus and is gradually making its presence felt. In 2007, the first year of operations for the bank, SGB posted a loss of SYP 128.3 million (US\$ 2.5 million). New branches are planned in Damascus and in Aleppo and scheduled to open during 2008. SGB offers a great investment prospect for UGB in the years to come.

Tunis International Bank (TIB) has continued to post strong results and in 2007 recorded a net profit of US\$ 16.2 million, up 37 percent from US\$ 11.9 million in 2006 with total assets posting 19.1 percent growth to US\$ 514.1 million as of the year end in 2007. Their representative office in Tripoli, Libya has actively contributed to business growth at the Bank.

New significant investments made during 2006 in North Africa Holding Company and Manafae Investment Company have started contributing to the income of the Bank in 2007 with respective amounts of US\$1.3 million and US\$ 4.5 million.

The Bank and its subsidiary, KAMCO, have joined forces with the Royal Group in the formation of a new investment company in Abu Dhabi, The Royal Capital Company. The Bank and KAMCO have subscribed 44 percent in AED 300 million (US\$ 82 million) capital of the company in September 2007. The company is scheduled to commence business during the second quarter of 2008.

### Growing asset base

Consolidated assets increased by 13.4 percent to US\$ 2.67 billion as at 31 December 2007 over US\$ 2.35 billion in 2006. Important new direct investments made during the year include US\$ 25 million for a 10 percent equity stake in Global Banking Corporation, a new Islamic investment bank in Bahrain, US\$ 10 million for a 10 percent equity ownership in Al Raya Investment Company, Kuwait, a new Islamic investment company incorporated in Kuwait, and US\$ 15.6 million for 27.4 percent ownership in United Real Estate Company, Jordan.

The Bank strengthened its funding base through a new five year US\$ 200 million syndicated medium term facility raised in June 2007. Shareholders' equity increased 35.3 percent to US\$ 661.8 million at the year end in 2007 from US\$ 489.2 million in 2006. Together with the minority interest and lower tier two subordinated notes, the regulatory capital base increased to US\$ 866.5 million as at 31 December 2007. The consolidated BIS ratio stood at 33 percent against 28.3 percent in 2006. UGB's solo BIS was around 23 percent as at 31 December 2007, increased from 18.8 percent in 2006.

The strong BIS ratios are further supported by a hidden value available in the Bank's core investments of publicly quoted subsidiaries and associates. The hidden value, being the excess of market value over the Bank's carrying cost, stood at US\$ 347.9 million as of 31 December 2007, significantly up from US\$ 271.8 million as of 31 December 2006.

### Credit ratings

The Bank enjoys Baa3/P-3 deposit ratings from Moody's who has also assigned it a D+ bank financial strength rating. Capital Intelligence ratings are BBB+/A2 with stable outlook.

### Market capitalization

The market confidence in the Bank's shares has considerably improved, reflecting the investors' growing interest. The 2007 year end closing price of 610 Bahraini fils posted a vast improvement over 365 Bahraini fils at the year end in 2006. Market capitalization shot up to US\$ 1.31 billion at the year end in 2007 from US\$ 777 million at the year end in 2006. The shares were one of the actively traded shares on the Kuwait Stock Exchange, where the Bank enjoys dual listing.

### Outlook

The year 2007 has been exceptionally profitable for the Bank with three important asset realizations posting substantial gains and impressive growth in the Bank's normalised profit.

As part of continuous efforts to enhance stakeholders' value, sharpen focus and improve performance, your Board has recently been engaged in examining a number of strategic options. Appropriate disclosure will be made when these plans are fully developed.

## Corporate Governance

The Bank is fully compliant with 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.

During 2007, the Board held eight scheduled and seven unscheduled meetings to consider various business proposals and financial strategic actions.

The Internal Audit Department provides an ongoing process of independent assessment, assurance on effectiveness and quality of controls as well as compliance parameters of the Bank. Other committees that oversee various functions of the Bank are the Management Committee, Asset and Liability Committee, Investment Committee, Board Executive Committee, Board Audit Committee, Insider Trading Committee and Risk and Compliance Committee.

As of 31 December 2007, Directors own 636,600 shares (636,600 shares in 2006) and Executive/Senior Management 3,673,226 shares (2006: 793,480 shares) of the Bank, the latter largely through exercise of their stock options. Executive/Senior Management and other staff have been granted 37.4 million share options under the Banks 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 2007, I am pleased to report that the Board has recommended to the Annual General Meeting the payment of a 65 percent in cash dividend (US 16.25 cents per share) (2006: 34.6 percent or US 8.65 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 (2006: US\$ 500,000) which is administrated under the supervision of Masharie Al Khair Charity, an organization formed to organize and focus on the charitable activities of KIPCO Group companies.

The Program also covers a scholarship scheme for select academically gifted and deserving children of the Bank 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 Deputy Supreme Commander, H H Sheikh Salman Bin Hamad Al Khalifa. Our thanks and gratitude to the Central Bank of Bahrain and the Governor, H E Mr Rasheed Mohammed Al Maraj, and the Capital Markets Supervision Directorate for their continuous support and understanding, and to the Ministry of Industry and Commerce and to the Stock Exchanges in Bahrain and Kuwait for their encouragement.

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

**Faisal Al Ayyar**  
Chairman