

Chairman's Statement



Faisal Al Ayyar
Chairman

Dear Shareholders

ON BEHALF OF THE BOARD OF DIRECTORS, it is my privilege to present the annual report of United Gulf Bank B.S.C. (UGB), for the financial year ended 31 December 2008.

I am pleased to report that your Bank posted the second best performance in our 29 year history, with a net income of US\$ 207.2 million, 6.2% below 2007's record high profits of US\$ 220.9 million. This is extremely creditable given the volatile economic conditions in which this result was achieved. It has been a challenge to maintain your Bank's standing in the midst of a credit and liquidity crisis which has witnessed the exit of some global banking stalwarts from the world financial landscape, but our results speak loud and clear.

UGB's strong performance impacted by impairment charge

UGB's business model, which is based on a combination of strategic investments in financial and non financial subsidiaries and associates, helped it weather the storm in extraordinarily depressed financial markets, characterized by deep erosion in asset prices. It is important to note that UGB's total revenues of US\$ 341.4 million posted in 2008 are only moderately down from income of US\$ 358 million in 2007 (excluding income from discontinued operations). The Bank was set on course to achieve its sixth consecutive year of record profits. However, the severity of the global financial crisis spread to the region's stock markets in the fourth quarter. As a result, the Bank's trading income dropped by over US\$ 100 million. UGB also decided to take a consolidated impairment charge of US\$ 56.7 million. Under these circumstances, it is highly commendable that your Bank was able to achieve a net income of US\$ 207.2 million.

The successful sale of the Bank's 43.86% stake in Jordan Kuwait Bank and its 30.4% stake in United Medical Services Company, were the chief contributors to UGB's net income for the year ended 2008. During 2008, an aggregate amount of US\$ 346.1 million was booked from the sale of associated companies and subsidiaries. In 2007, US\$ 109.4 million was derived from the sale of investments in United Fisheries of Kuwait, Wataniya Telecom and United Projects for Aviation Services Company. Other contributors to revenues in 2008 came from a US\$ 23.9 million gain on the sale of investments available for sale, US\$ 22.7 million from dividends received and US\$ 56.3 million from fees and commissions. These helped absorb the unrealized loss of US\$ 92.7 million on investments held in the trading book. UGB's total assets as at year end 2008, were US\$ 2.9 billion – 7.6% higher than US\$ 2.7 billion in 2007.

Other key 2008 performance indicators demonstrating UGB's resilience, were an earnings per share of US 25.3 cents (2007: US 27.3 cents), a return on average equity of 30.4% (2007: 38.4%), and a return on average assets of 7.5% (2007: 8.8%). As mandated by the Central Bank of Bahrain, the Bank

became Basel II compliant effective 1 January 2008. The capital adequacy ratio as per these standards is 17.2% on a consolidated basis (2007: 33% following the Basel I norms). Another positive factor is that operating expenses were US\$ 56.5 million vs US\$ 61.4 million in 2007. This represents an operating expenses to operating income ratio of 20.7% in 2008 vs 21.2% in the previous year. There has been a calculated effort to ensure that operating costs are held in check.

In my 2007 statement, I mentioned that your Board has been engaged in analyzing strategic options, as part of its efforts to enhance stakeholders' value and improve performance. In line with this objective, it was announced in May 2008 that a decision was taken by the Board of Kuwait Projects Company (Holding) (KIPCO – UGB's parent company), to consolidate all the commercial banking activities under the Burgan Bank umbrella and investment banking activities under UGB. This would achieve economies of scale in order to compete and create value. In line with this strategy, UGB agreed to sell its stakes in its four commercial banking operations (Algeria Gulf Bank, Bank of Baghdad, Jordan Kuwait Bank, and Tunis International Bank) to Burgan Bank for a total consideration of US\$ 725 million. The transfer of Jordan Kuwait Bank was successfully completed in the third quarter of 2008 for a cash payment of US\$ 450 million.

UGB was to use the proceeds of US\$ 725 million to acquire up to a 20% equity stake in Burgan Bank, by subscribing to a special rights share issue at KD 1 per share. This was subject to procuring the necessary regulatory approvals by Burgan Bank including a Kuwaiti Amiri Decree. The Decree was not received within the Central Bank of Kuwait's stipulated deadline of 31 December 2008. Consequently, this aspect of the transaction could not be completed. Nevertheless, both Burgan Bank and UGB have announced their intention to successfully complete the transfer of the remaining three banks as early as possible in 2009.

UGB's regional network

UGB continues to have strategic investments in a number of financial and non financial subsidiaries and associates. Your Board fully recognizes the increasing importance of diversification in enabling the Bank to withstand recessionary conditions in any one particular sector.

As a banking services provider in the MENA markets, the Bank adhered to its strategy of supporting its commercial and investment banking network throughout the Middle East and North Africa region. In 2008, the contributions from the commercial banks in its portfolio, namely Algeria Gulf Bank, Bank of Baghdad and Tunis International Bank, were especially noteworthy. After the sale of these banks, your Board will endeavor to invest the proceeds into investments which provide a steady stream of revenues, particularly in asset management and investment banking.

In the wealth and asset management business, KIPCO Asset Management Company (KAMCO) posted a net income of US\$ 4.1 million for the financial year ending 2008. This is a sharp fall from the corresponding figure of US\$ 135.9 million in 2007 that included exceptional gains from the sale of KAMCO's stake in Wataniya Telecom and United Fisheries of Kuwait. Total revenues of US\$ 42.1 million from investments and US\$ 57.1 million from fees and commissions, were adversely impacted by an impairment charge of US\$ 28.8 million that was taken on account of writedowns in the 'available for sale' portfolio. Assets under management were US\$ 9 billion in 2008, compared to US\$ 8.5 billion in 2007. KAMCO continues to excel in its equity research capabilities, with improved coverage and its readership.

The asset management and investment banking business at United Gulf Financial Services (UGFS), Qatar, was established in the first quarter of 2007 with the objective of providing corporate finance and asset management services to high net worth individuals and small businesses in Qatar. The meltdown in the financial markets and the erosion in asset prices resulted in UGFS posting a loss of US\$ 3.2 million in 2008. After assessing the current economic climate characterized by a prolonged recessionary outlook and a continuing fall in regional stock markets, your Board, in conjunction with other shareholders of UGFS, has decided to wind up the company's operations. Our commitment to Qatar remains strong, which we view as a strategic market that we hope to reenter at an appropriate time in the future. The activities of our Bahrain subsidiary, United Gulf Bank Securities (UGBS), Bahrain, continues at a moderate pace. UGBS currently has a very limited role and impact on UGB's revenues and balance sheet. There are plans to expand its role in the local asset management and corporate finance areas as and when opportunities arise.

The year 2008 was a record year of profits for UGB's commercial banking subsidiary in Algeria, Algeria Gulf Bank (AGB). Net income rose to US\$ 14.4 million and represented an impressive growth of 84% over the previous year's net profit of US\$ 7.8 million. The bank has a healthy mix of revenues from interest income on its loan book (US\$ 15.5 million) and from fees and commissions (US\$ 18.9 million). An expansion in the retail and corporate portfolios resulted in loans and advances increasing to US\$ 258.7 million. This comprises nearly 75% of the total balance sheet of US\$ 344.5 million (2007: US\$ 189.9 million). Provision for non performing loans was relatively low at US\$ 3.2 million. AGB has thirteen branches across Algeria, seven having been opened in 2008.

Another subsidiary of UGB that had a historically high year of profits was Tunis International Bank (TIB). Net income for the year ended 2008 rose by 22.2% to US\$ 19.8 million. The main contributors to its revenues came from interest income, foreign exchange, fees and commissions and dividend income. Provision for bad debt was US\$ 0.3 million. Total assets of TIB

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declined marginally by 3% over the previous year to US\$ 499 million. TIB operates as an offshore bank.

UGB's subsidiary, Bank of Baghdad (BoB), one of the largest private commercial banks in Iraq, had yet another successful year. UGB continues to provide management advisory services to BoB, which posted a record high net income of IQD 20.3 billion (US\$ 17.2 million). This represents a 21.5% increase over 2007's comparative figure of IQD 16.7 billion (US\$ 13.8 million). The major contributor to BoB's revenues was investment income from local Treasury Bills, which rose three times to US\$ 12 million in 2008. BoB has a network of 25 branches which are all interconnected and online twenty four hours a day, seven days a week. BoB provides innovative banking products and services to the Iraqi market such as debit cards, ATM services and MasterCard credit cards.

Syria Gulf Bank (SGB), in which UGB has a 27.5% stake, commenced its operations as a commercial bank in June 2007. Its mandate is to provide retail and commercial banking products that encompass credit and loan facilities, deposits, trade finance and correspondent banking services. The bank has a management agreement with UGB, through which UGB provides the necessary support and services to SGB. In 2008, the first full year of the bank's operations, SGB recorded a loss of SYP 156 million (US\$ 3.1 million). SGB currently has three operating branches and is set to expand its network further, by opening its branch in Aleppo and other important cities and towns in the current year.

Your Bank made a new significant investment in March 2008 by acquiring a 32.5% stake in the Millennium Finance Corporation (MFC). MFC is an Islamic investment bank licensed by the Dubai Financial Services Authority in the United Arab Emirates. UGB has Dubai Islamic Bank as its partner in this company. MFC advises corporations and governments on major M&A transactions, private equity placements and capital market operations in the GCC region and beyond, and is planning a family of specialized regional private equity funds.

The Bank and its subsidiary, KAMCO, have also invested with the Royal Group of the UAE to form a new investment company in Abu Dhabi, the Royal Capital Company. UGB and KAMCO together own 44% of its capital. The company is well positioned to capitalize on the opportunities available in the UAE, particularly Abu Dhabi which is committed to giving strong support to the local economy.

On the liquidity front, UGB raised a new three year club loan of US\$ 115 million and repaid its maturing three year Murabaha obligation of US\$ 175 million in October 2008.

UGB's Capital Adequacy Ratio is a testimony to its financial strength. Effective 1 January 2008, the Bank adopted the Basel II

norms as mandated by its regulator, the Central Bank of Bahrain. On a solo basis, the capital adequacy ratio was at a comfortable level of 15% against the minimum requirement of 8%. On a consolidated basis, it stands at 17.2% against the minimum requirement of 12%.

Credit Ratings

The rating agencies have reaffirmed their faith in UGB's strategy and performance. In its latest rating review report dated October 2008, Capital Intelligence maintained its BBB+/A2 rating with a stable outlook for the Bank.

Additionally, the assigned Baa3/P-3 deposit rating from Moody's alongside a financial strength rating of D+, was put on a review watch in May 2008, following the announcement by UGB that it had agreed to sell four commercial banking subsidiaries and associates to Kuwait's Burgan Bank (rated BBB+ by S&P) for US\$ 725 million. As stated in Moody's rating announcement dated 27 November 2008, provided the restructuring transaction goes ahead as planned, the most likely outcome of the review would be a confirmation of the BFSR at D+.

Corporate Governance

Sound corporate governance is critical to UGB's goal of creating long term value for stakeholders. UGB continued to strengthen its corporate governance and risk management framework, based on segregation of functions and responsibilities, enhanced transparency and accountability, attention to detail on the controls necessary for effective risk management, adherence to regulatory compliance and the accurate disclosure of information to the market within stipulated deadlines. These are the foundations of the Bank's corporate governance policy.

The composition of the Bank's Board of Directors changed during the year, with Mr Samer Khanachet replacing Mr Tariq Mohamed Abdul Salam. I thank Mr Abdul Salam for his valuable contribution to UGB's progress over the past seven years, and simultaneously welcome Mr Khanachet as a new member of the Board. His long association with the KIPCO Group and his sharp business acumen has been of great benefit in guiding UGB's future strategic direction.

UGB is committed to maintaining excellent professional relationships – both internally between the Bank's Board of Directors, its Committees and its Senior Management team – and externally, with shareholders, the Central Banks and other regulatory bodies, and the business communities in the various countries that the Bank operates in.

The Internal Audit and Quality Assurance Department provides the Board Audit Committee and Senior Management with an ongoing process of independent and objective assessment

and assurance on effectiveness and quality of controls. Through a systematic risk based audit approach, the department aims at adding value and introducing continuous improvements to the Bank's overall operations and procedures, in line with applicable regulatory requirements and best practices. In the year 2008, the department conducted a total of 89 audit assignments covering UGB and its core subsidiaries.

As of 31 December 2008, Directors own 636,600 shares (636,600 shares in 2007) and Executive/Senior Management own 1,906,597 shares (1,563,346 shares in 2007) of the Bank. This is mainly through the exercise of stock options. The staff of UGB have been granted 36.5 million shares under the Bank's employee stock option plan, as approved at the EGM held on 24 March 2004.

Thanks

Finally, 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 are

extended to the Central Bank of Bahrain and its Governor H E Mr Rasheed Mohammed Al Maraj, the Capital Markets Supervision Directorate, the Ministry of Industry and Commerce, the Bahrain Stock Exchange and the Kuwait Stock Exchange, whose support and guidance are sincerely appreciated. Their encouragement and understanding is overwhelming.

I thank our shareholders and all stakeholders for their ongoing support and extend my appreciation and thanks to our management and staff, who have maintained their commitment and loyalty, in contributing to our achievements and success.

Faisal Al Ayyar

Chairman