Qatar National Bank

- Loan portfolio dominated by government segment.
- High assets quality.
- Strong margins.
- Net income estimated CAGR (2009-13) of 21%.

BUY

Target Price
QR 155.5

Market Data

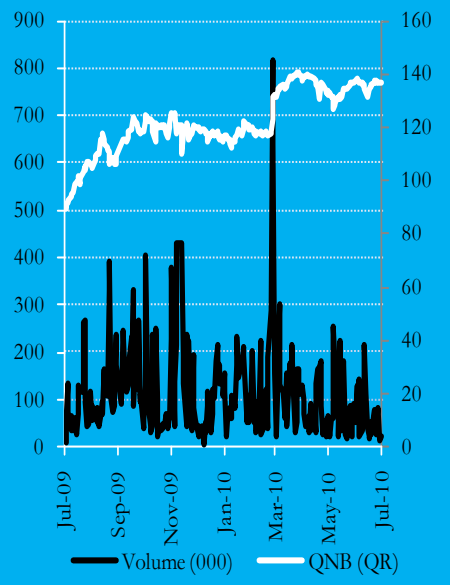
Bloomberg Code:	QNBK QD
Reuters Code:	QNB.QA
CMP (22nd July 2010):	QR135.9
O/S (mn):	391.5
Mkt Cap (QR mn):	53,199.0
Mkt Cap (US$ mn):	14,603.1
P/E 2010e (x):	9.8
P/Bv 2010e (x):	2.4

Price Performance 1-Yr

High /Low (QR):	140.90 / 89.46
Average Volume (000):	117.0

	1m	3m	12m
Absolute (%)	-1.8	-2.5	51.8
Relative (%)	0.1	6.5	39.9

Relative Performance



Source: Bloomberg, & Zawya

Faisal Hasan, CFA
Head of Research
fhasan@globalinv.com.kw
Phone: 2295 1270

Khalid Alsahli, CAIA
Financial Analyst
kalsahli@globalinv.com.kw
Phone: 2295 1294

Economic expansion to drive loan growth

Qatar National Bank (QNB)'s gross portfolio is expected to register 21% CAGR over 2009-2013. The growth in the overall lending activities will be driven by the economic boom that the country is going through at the moment. Even though private and retail segments are expected to play bigger role in the future, government lending would still constitute a major part of the portfolio.

Attractive returns supported by higher net interest income

ROAE and ROAA are expected to average 27.7% and 2.8% over 2010-2013. These strong returns are supported by NII. High spreads, coupled with loan volume growth, would benefit QNB, in the form of higher net interest income (NII). Meanwhile, non-interest income is to lack momentum in 2010, but to resume stronger growth thereafter.

Low risk exposures

QNB enjoys low risk profile, even though QNB has the lowest CAR ratio in our coverage (13.2%). QNB benefits from government segment's overweight in the lending portfolio, low equity size, and the backing of a booming economy, combined with expansionary fiscal policy.

*Valuations - **BUY** with an upside potential of 14.5%*

According to our estimated fair value of QNB at QR155.5 per share, the banking scrip offers an upside potential of 14.5% on the closing price (as on July 22, 2010) of QR135.9 per share. Therefore, we upgrade our recommendation to "**BUY**" on QNB stock with medium term perspective.

Investment Indicators

	2007	2008	2009	2010 (F)	2011 (F)	2012 (F)	2013 (F)
Net Income (QR mn)	2,507.5	3,652.5	4,201.7	5,438.3	6,512.2	7,649.4	8,893.3
ROAE	24.3%	26.3%	25.2%	26.8%	27.3%	28.0%	28.6%
EPS (QR)	6.4	9.3	10.7	13.9	16.6	19.5	22.7
BVPS (QR)	33.1	37.9	47.5	56.3	65.4	74.5	84.7
P/E (x)	16.7	11.3	10.7	9.8	8.2	7.0	6.0
P/BV (x)	3.2	2.8	2.4	2.4	2.1	1.8	1.6

*Source: Company Annual Reports & **Global** research*
**Historical P/E & P/BV multiples pertain to respective year-end prices, while those for future years are based on closing prices on QE as of 22nd July, 2010.*

Valuation & Recommendation

For arriving at the fair value of QNB share, we have used the two valuations methods (DDM & GGM).

Dividend Discounting Model - DDM

Our use of DDM valuation is based on a 4-year forecast of dividends as cash flows (2010-13). We have used following assumptions in order to arrive at the equity value of the bank:

- Cost of Equity (COE) derived using Capital Asset Pricing Model (CAPM) is estimated to be 10.6% based on the following assumptions:
  - Risk-free rate of 4.6%.
  - Market risk premium of 6.0%.
  - Beta of 1.0 (based on 5 years monthly data from Bloomberg). If the actual beta of the bank is less than 1 or if the data available is of less than 5 years, we have taken it as 1.

- Terminal growth rate of 3.0%.

DDM Valuation

(QR mn)		2009F	2010F	2011F	2012F	Terminal Value
Dividends Expected		1,958	2,937	4,112	4,892	66,539
PV of Dividends Expected	11,088					
PV of Terminal Value	47,058					
Estimated Fair Value of Equity	58,146					
No. of Shares Outstanding (mn)	391.5					
Fair Value as per DDM (QR)	148.5					

*Source: **Global** Research*

Sensitivity Analysis

We have also prepared a sensitivity analysis for the estimated fair price of the share based on various terminal growth rates and COE.

Sensitivity analysis -DDM

		Terminal Growth Rate				
		2.0%	2.5%	**3.0%**	3.5%	4.0%
Cost of Equity	9.6%	151.7	161.1	171.8	184.3	199.1
	10.1%	142.0	150.1	159.3	170.0	182.3
	10.6%	133.5	140.5	**148.5**	157.7	168.2
	11.1%	125.9	132.1	139.1	147.0	156.0
	11.6%	119.1	124.6	130.7	137.6	145.4

*Source: **Global** Research*

Gordon Growth Model – GGM

The adaptation of the Gordon Growth model uses the sustainable return on average equity (ROAE), cost of equity (COE) and expected growth in earnings (g) to calculate the target P/BV of the bank. Under this methodology, we have used the following assumptions to arrive at the fair value of the bank:

- Sustainable ROE calculated as the average ROAE of the forecasted 4 years.
- Cost of Equity derived using CAPM, using the same assumptions as in the DDM.
- Terminal growth rate of 3.0%, similar to the DDM.

Gordon Growth Model

Average ROE	27.7%
COE	10.6%
g	3.0%
2010: P/BV target multiple	3.3
2010: BV/share	56.3
GGM Value per share	**183.6**

*Source: **Global** Research*

Sensitivity Analysis

This sensitivity analysis shows the movement in fair value as a consequence of different ROE and COE assumptions.

Sensitivity analysis -GGM

		Return on Equity				
Cost of Equity		25.7%	26.7%	**27.7%**	28.7%	29.7%
	9.6%	194.4	202.9	211.5	220.1	228.6
	10.1%	180.6	188.6	196.5	204.5	212.5
	10.6%	168.7	176.1	**183.6**	191.0	198.4
	11.1%	158.2	165.2	172.2	179.2	186.2
	11.6%	149.0	155.6	162.2	168.7	175.3

*Source: **Global** Research*

Valuation

Based on the current market price of QR135.9 per share (as on July 22, 2010), the bank is traded at 2010E P/E and P/BV multiples of 9.8x and 2.4x.

Valuation Summary

Valuation Methods	Fair Value/ Share (QR)	Weightage	Weighted Value (QR)
DDM	148.5	80%	118.8
GGM	183.6	20%	36.7
Estimated Fair Value			**155.5**

*Source: **Global** Research*

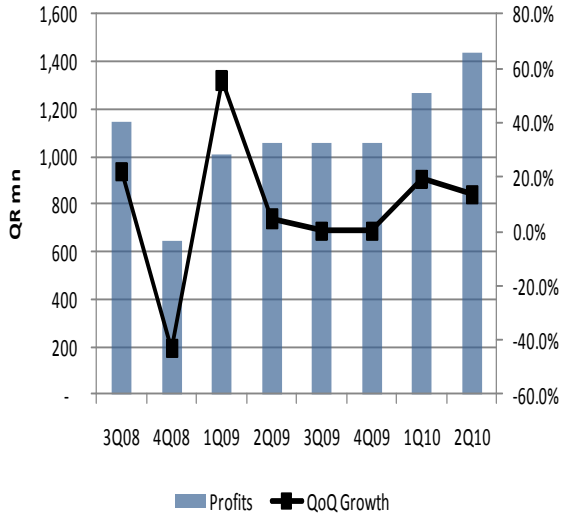
According to our estimated fair value of QNB at QR155.5 per share, the banking scrip offers an upside potential of 14.5% on the closing price (as on July 22, 2010) of QR135.9 per share. Therefore, we upgrade our recommendation to "**BUY**" on QNB stock with medium term perspective.

Qatar National Bank -Financial Update

First Half 2010 Review

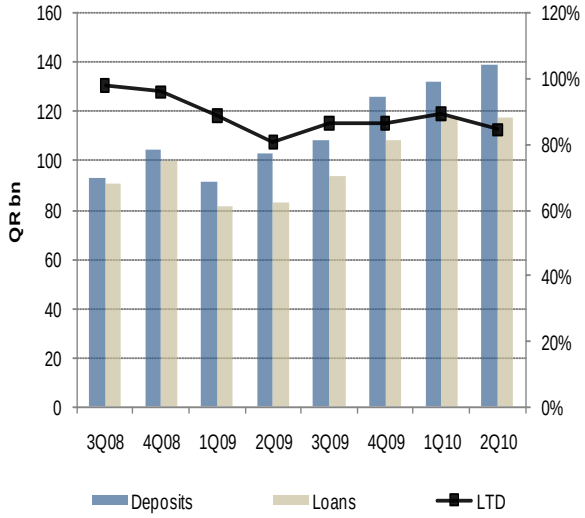
- QNB continued its impressive performance by recording QR2.7bn in profits for 1H2010, 31% YoY. On a quarterly basis, QR1.4bn was recorded in 2Q2010, higher by 36% YoY and 14% QoQ.

Chart 01: Quarterly Profitability Growth



*Source: QNB financials& **Global** Research*

Chart 02 : Quarterly Loans & Deposits



*Source: QNB financials& **Global** Research*

- The main driver behind profitability growth was net interest income (including Islamic income) which registered QR2.6bn in 1H2010, up by 45% YoY. In 2Q2010, QR1.4bn was recorded, up by 47% YoY and by 15% QoQ.

- On the other hand, non-interest income witnessed a slight increase by (QR6mn) in 1H2010 to reach QR965mn. The main cause behind the stagnancy in the non-interest income was the weak performance in dividend income and investment income.

- Cost to income ratio stood at 17.2% in 1H2010, as compared to 18.6% in 1H2009.

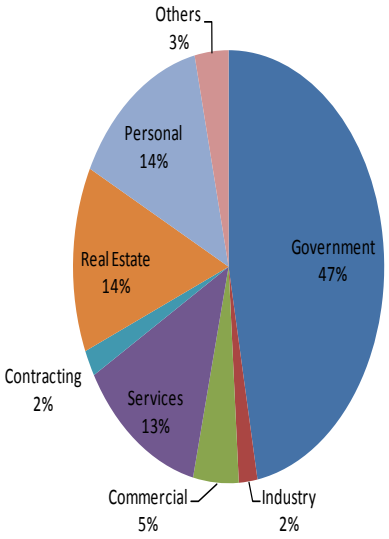
- Net loans portfolio grew by about 8% YTD to QR117.6bn in 1H2010, but experienced a slight decline (QR0.1bn) during 2Q2010. On the other hand, deposits (including unrestricted investment account) grew by 10.6% YTD to reach QR139bn.

- QNB witnessed slightly higher NPLs to QR944mn in 2Q2010, as compared to QR889mn in 1Q2010. NPL ratio also experienced a slight increase in 2Q2010 to 0.79%.

Loan portfolio to benefit from expanding economy

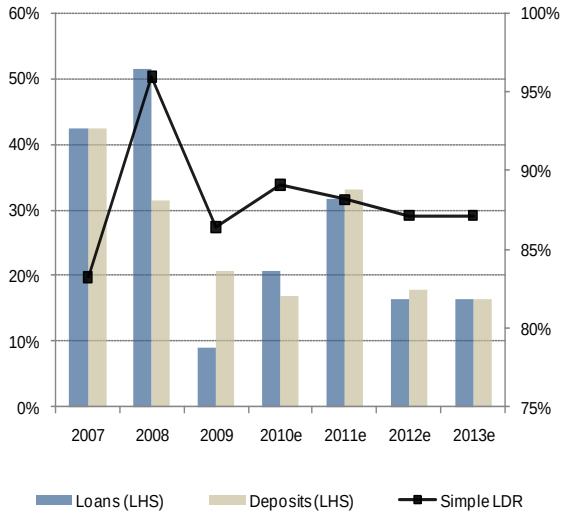
Lending activities recorded a moderate growth of 9.0% in 2009, despite the financial crisis. However, the composition of the loan portfolio changed slightly because of the increase in government and corporate lending, while the retail segment witnessed a decline of 24% YoY in 2009 to constitute only 14%, as opposed to 21% in 2008. The overall Qatari banking sector also witnessed difficulties in the retail segment, as evident by the data released by the Central Bank showing that the retail segment constituted 20% of the sector lending portfolio in May 2010, as compared to 24% in the same period a year earlier.

Chart 03: FY2009 Loan Portfolio



*Source: QNB financials & **Global** Research*

Chart 04: Loans & Deposits Growth



*Source: QNB financials & **Global** Research*

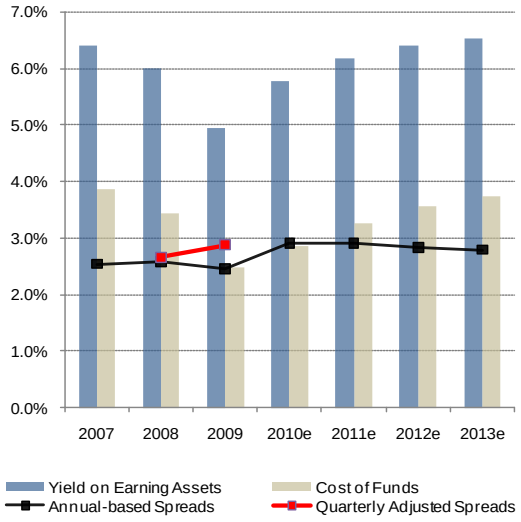
We expect that government lending would continue growing, but at a lesser pace, while private sector will continue at its pace. In the same time, retail lending would reverse its direction and start growing. Government lending would still constitute a major part of the portfolio. Our estimates show that overall gross portfolio will register 21% CAGR over 2009-2013. On other hand, growth will take another shape, where Islamic assets will be a major component of the lending portfolio. At the end of 2Q2010, Islamic loans constituted around one fifth of gross loans.

The growth in the overall lending activities will be driven by the economic boom that the country is going through at the moment. IMF estimates that real GDP will be 18.5% and 14.3% in 2010 and 2011, respectively. This expected growth is to be driven by the expansion in natural gas production. Even though most of the energy's revenue is channeled outside the country, the government's expansionary fiscal policy includes major infrastructure projects that will target increasing non-oil GDP.

Strong margins to drive NII

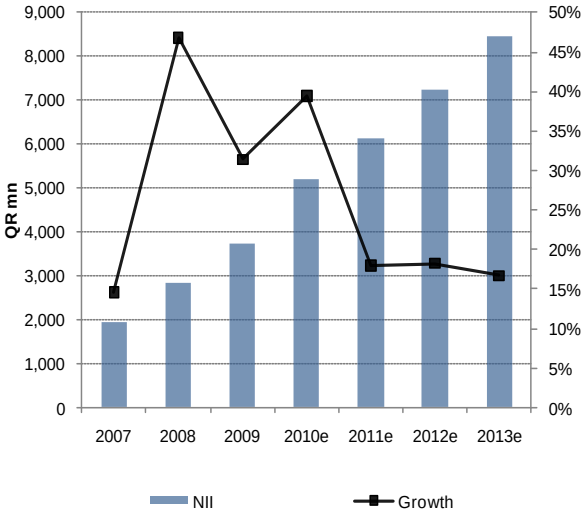
Analysis of yields and cost of funds shows that spreads have declined marginally in 2009. However, annual calculation in this case might not show the real picture because this methodology relies on year-end balance sheet values, and it neglects quarterly fluctuations. QNB witnessed a drop in its loan portfolio by about 20% in the first quarter of 2009, due to the government program to buy some of the Qatari banks' assets including part of their loan portfolios. After adjusting for the quarterly fluctuations, spreads have actually increased by 22bps to 2.88%.

Chart 05: Spreads



*Source: QNB financials & **Global** Research*

Chart 06: Net Interest Income



*Source: QNB financials & **Global** Research*

Spreads are expected to hold at current levels (quarterly-adjusted spreads) in 2010, as yield and cost of funds stay stable. Even as the overall interest rates increase post 2010, spreads are expected to stay within approximately their 2010 level.

Strong margins would benefit QNB, in the form of higher net interest income (NII). Another factor to drive growth in NII is volume growth in lending activities. Post 2010, NII will continue growing, as spreads continue at their levels coupled with healthy volume growth. NII is expected to grow at a CAGR of 23% over 2010-2013. The major component growth is estimated to be net Islamic income, since Islamic loans will have bigger share in the overall loan portfolio, coupled with better margins. Net Islamic income is expected to more than double in 2010 alone.

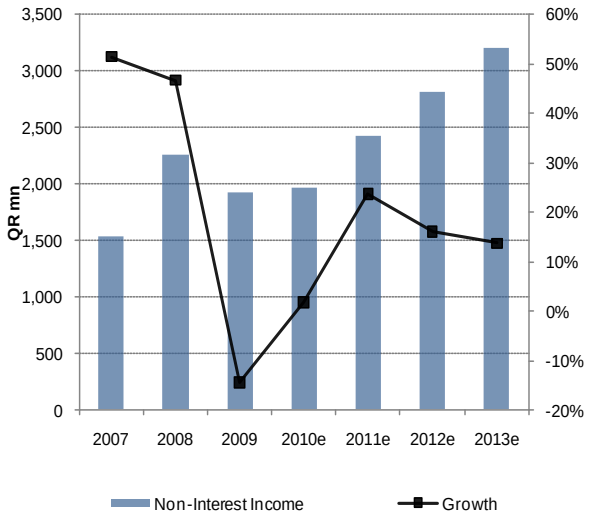
Overall, net Islamic income will have an increased share in profits, in line with expected growth in Islamic assets. Net Islamic income constituted 11% of overall NII in 2009, and this share is expected to rise to 20% by 2013.

Non-interest revenue to lack momentum in 2010

Despite the stellar performance carried by QNB, non-interest income was not as impressive (decrease of 14% in 2009). First, gains from investment, which were a major driver of growth in the past, witnessed a drop in 2009, and are not expected to return to previous level any time soon. This is due to the sharp decline in the equity portfolio which will cause the investment income to continue declining sharply in 2010. Thereafter, gains from investments should improve, as the bank starts building up the equity portfolio combined with better market performance. Second, other sources of revenues have been affected but at a lesser degree. Gains from foreign currency dealing declined slightly, but are expected to resume growth in 2010. Meanwhile, profit from associates is expected to decline slightly in 2010.

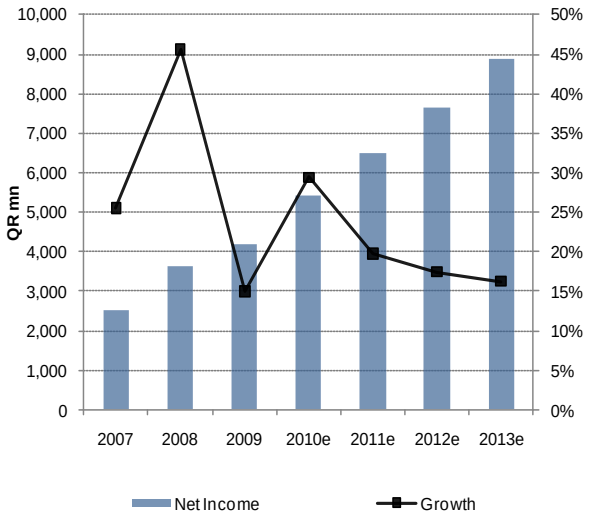
Finally, increased competition in the sector will cause fees & commissions to have lower future growth rate when compared with previous years. Our estimates indicate that fees & commission will have a CAGR of 16% over 2009-2013, as compared to a CAGR of 26% over 2005-2009. Putting it all together, non-interest income growth is expected to be small in 2010, but to resume double-digits growth thereafter. Our forecast shows that non-interest income CAGR will be 14% over 2009-2013.

Chart 07: Non-Interest Income



*Source: QNB financials & **Global** Research*

Chart 08: Net Income



*Source: QNB financials & **Global** Research*

High returns

QNB has reported one of the highest returns. In 2009, the bank recorded a return on average equity (ROAE) of 25.2%, while return on average assets (ROAA) was 2.5%. Strong returns are expected to continue in 2010, fueled by NII. We estimate that ROAE and ROAA will average 27.7% and 2.8%, respectively, over 2010-2013. Meanwhile, net income is expected to have a CAGR of 21%.

Risks are minimal

QNB carries low level of risk in its balance sheet mainly because of high asset quality. First, almost half of its loan portfolio consists of government lending, which explains why the bank enjoys the lowest NPL ratio in Qatar (0.79% as of 2Q2010). In addition, corporate portfolio, which constitutes 39% of loan portfolio, has not experienced any major default at the peak of the crisis. Thus, the probability of a sharp rise in NPLs in this segment has been considerably reduced.

Nevertheless, retail segment has been severely hit, in line with the overall banking sector. In fact, most of the existing non-performing loans are believed to be caused by the retail segment, where 86% of specific provisions taken in 2009 were from retail loans (including mortgages). However, we don't expect the retail segment to cause major asset deterioration because of its relatively small size.

Apart from lending activities, the bank's investment portfolio witnessed a drop in its equity component to barely QR145mn, due to the Qatari government's program to buy back Qatari banks' investment portfolios. The portfolio is now composed almost entirely of debt instruments, most of which are Qatari sovereign bonds. Thus, no major financial provisions are expected.

In short, the bank still enjoys low risk profile, even though QNB has the lowest CAR ratio in our coverage (13.2% as per 2009 financials). QNB benefits from government segment's dominance in the lending portfolio, low equity size, and the backing of a booming economy, combined with expansionary fiscal policy.

Income Statement	Qatar National Bank						
(QR mn)	**2007**	**2008**	**2009**	**2010 (F)**	**2011 (F)**	**2012 (F)**	**2013 (F)**
Interest Income	4,623	6,116	6,395	7,913	9,830	12,298	14,611
Interest Expense	(2,855)	(3,607)	(3,081)	(3,686)	(4,966)	(6,514)	(7,867)
Net interest income	1,768	2,509	3,314	4,227	4,864	5,784	6,743
Income from Islamic financing and investing activities	418	689	901	1,969	2,751	3,478	4,168
Unrestricted Investment Account Holders' Share of Profit	(253)	(363)	(489)	(1,001)	(1,487)	(2,016)	(2,455)
Net Islamic Financing	165	326	412	968	1,264	1,462	1,713
Net Financing Activities	1,932	2,836	3,726	5,195	6,128	7,246	8,457
Fees and commission	726	917	968	1,221	1,409	1,594	1,734
Investment Income	497	707	347	113	250	345	491
Net Gains from Dealing in Foreign Currencies	175	328	305	358	423	467	524
Share in Profit of Associates	123	200	293	249	286	341	373
Other Operating Income	16	104	18	25	65	76	89
Non-Interest Income	1,537	2,255	1,931	1,967	2,433	2,823	3,211
Net Operating Income	**3,469**	**5,091**	**5,657**	**7,162**	**8,561**	**10,069**	**11,668**
Provisions	(42)	(378)	(359)	(398)	(368)	(348)	(353)
Operating Expenses	(901)	(1,042)	(1,107)	(1,297)	(1,642)	(2,022)	(2,357)
Profit before taxes	2,525	3,671	4,191	5,467	6,551	7,699	8,959
Taxes	(19)	(20)	(17)	(27)	(33)	(38)	(45)
Profit from Discontinued operations	-	2	14	-	-	-	-
Net Income	**2,506.1**	**3,652.5**	**4,188.5**	**5,440**	**6,518**	**7,661**	**8,914**
Minority Interest	(1)	-	(13)	1	6	11	21
Net Income attributable to shareholders	2,508	3,653	4,202	5,438	6,512	7,649	8,893
P&L Appropriation Account:							
Retained Earnings Brought Forward	1,130	1,454	1,249	2,439	4,040	5,474	6,889
Net Profit for the year	2,508	3,653	4,202	5,438	6,512	7,649	8,893
Proposed Dividend	(912)	(1,807)	(1,204)	(1,958)	(2,937)	(4,112)	(4,892)
Proposed Issue of Bonus Shares	(365)	(602)	(903)	-	-	-	-
Movements in Reserve	(907)	(1,448)	(903)	(1,840)	(1,989)	(1,999)	1,541
Cl Balance of Retained Earnings	1,454	1,249	2,439	4,080	5,626	7,012	12,430

*Source: Company Reports & **Global** Research*

Balance Sheet	Qatar National Bank						
(QR mn)	**2007**	**2008**	**2009**	**2010 (F)**	**2011 (F)**	**2012 (F)**	**2013 (F)**
Cash & balances with banks	10,949	6,270	9,880	12,203	16,615	14,496	14,956
Due from Banks and Other FIs	21,303	27,044	30,181	25,004	30,367	36,473	43,776
Loans and advances (Gross)	66,472	100,678	109,707	132,377	174,363	203,142	236,334
Provisions	(408)	(625)	(924)	(1,298)	(1,653)	(1,975)	(2,295)
Financial Investments	11,309	11,815	23,333	24,149	27,769	31,451	35,564
Investment in associates & joint venture	2,704	4,597	4,444	4,693	5,683	6,024	6,698
net fixed assets	651	618	713	678	971	1,131	1,247
Other assets	1,381	1,576	1,995	2,394	2,992	3,441	3,854
Total Assets	**114,361**	**151,974**	**179,329**	**200,200**	**257,107**	**294,183**	**340,134**
Due to banks and other FIs	9,928	19,721	20,794	15,596	18,715	21,709	24,314
Repurchase agreements	2,495	2,267	2,086	2,138	2,202	2,400	2,484
Deposits from customers	74,181	94,973	108,772	124,001	162,441	191,680	222,349
Other Borrowings	6,715	6,719	6,724	6,717	6,724	-	-
Other liabilities	2,000	2,370	3,881	4,464	4,798	5,758	6,507
Proposed dividend	912	1,807	1,204	1,958	2,937	4,112	4,892
Total Liabilities	96,232	127,857	143,462	154,872	197,817	225,659	260,546
Unrestricted investment accounts	5,183	9,280	17,100	23,085	33,473	39,163	46,212
Minority interest	1	-	191	192	198	210	230
Paid-up equity capital	1,825	2,409	3,011	3,915	3,915	3,915	3,915
Statutory reserve	3,853	6,829	7,651	8,554	9,642	10,944	12,474
Other reserve	1,752	1,790	1,769	1,769	1,769	1,769	1,769
Risk reserve	783	1,410	1,410	2,163	2,850	3,319	-
Fair value reserve	2,347	(274)	489	522	668	785	927
Proposed bonus shares	365	602	903	-	-	-	-
Proposed transfer to statutory reserve	568	821	903	1,088	1,302	1,530	1,779
Retained earnings	1,454	1,249	2,439	4,040	5,474	6,889	12,282
Total Shareholder's Equity	12,945	14,837	18,577	22,051	25,619	29,151	33,146
Total Liabilities & Shareholders' Equity	**114,361**	**151,974**	**179,329**	**200,200**	**257,107**	**294,183**	**340,134**

*Source: Company reports & **Global** Research*

FACT SHEET	Qatar National Bank						
	2007	2008	2009	2010 (F)	2011 (F)	2012 (F)	2013 (F)
Profitability							
ROAA	2.7%	2.7%	2.5%	2.9%	2.9%	2.8%	2.8%
ROAE	24.3%	26.3%	25.2%	26.8%	27.3%	28.0%	28.6%
NII to Total Income	55.7%	55.7%	65.9%	72.5%	71.6%	72.0%	72.5%
Dividend Pay-out	36.4%	49.5%	28.7%	36.0%	45.1%	53.8%	55.0%
Margins							
Interest Expense to Interest Income	61.7%	58.3%	48.9%	47.4%	51.3%	54.1%	55.0%
Yield	6.4%	6.0%	4.9%	5.8%	6.2%	6.4%	6.5%
Cost of funds	3.9%	3.4%	2.5%	2.9%	3.3%	3.6%	3.8%
Spread	2.5%	2.6%	2.5%	2.9%	2.9%	2.8%	2.8%
Net Interest Margin (NIM)	2.4%	2.5%	2.5%	3.0%	3.0%	2.9%	2.9%
Efficiency							
Cost to Total Income	25.9%	20.5%	19.6%	18.1%	19.2%	20.1%	20.2%
OPEX/Average Assets	1.1%	0.9%	0.8%	0.8%	0.8%	0.8%	0.9%
Liquidity							
Loans to Customer Deposits	83.2%	96.0%	86.4%	89.1%	88.2%	87.1%	87.1%
Customer Deposits to Equity	613%	703%	678%	667%	765%	792%	810%
Customer Deposits to Total Assets	69%	69%	70%	73%	76%	78%	79%
Due from Banks to Due to Banks	215%	137%	145%	160%	162%	168%	180%
Credit Quality							
Provisions to Total Income	1.2%	7.4%	6.3%	5.6%	4.3%	3.5%	3.0%
Non Performing Loans (QR mn)	451	732	849	1,138	1,531	1,828	2,125
Loan Loss Reserve (QR mn)	408	625	924	1,298	1,653	1,975	2,295
NPLs to Gross Loans	0.7%	0.7%	0.8%	0.9%	0.9%	0.9%	0.9%
Loan Loss Reserve to Gross Loans	0.6%	0.6%	0.8%	1.0%	0.9%	1.0%	1.0%
NPL Coverage	91%	85%	109%	114%	108%	108%	108%
Capital Adequacy							
Equity to Total Assets	11%	10%	10%	11%	10%	10%	10%
Equity to Gross Loans	19%	15%	17%	17%	15%	14%	14%
RATIO USED FOR VALUATION							
Shares in Issue (000)	182,498	240,897	301,121	391,457	391,457	391,457	391,457
adj. EPS (QR)	6.4	9.3	10.7	13.9	16.6	19.5	22.7
adj. Cash Dividends	5.0	7.5	4.0	5.0	7.5	10.5	12.5
adj Book Value Per Share (QR)	33.1	37.9	47.5	56.3	65.4	74.5	84.7
adj. Market Price Year End (QR)	106.96	105.4	114.7	135.90	135.90	135.90	135.90
Dividends Yield	4.7%	7.1%	3.5%	3.7%	5.5%	7.7%	9.2%
P/E	16.7	11.3	10.7	9.8	8.2	7.0	6.0
P/BV	3.2	2.8	2.4	2.4	2.1	1.8	1.6

*Source: Company Annual Reports & **Global** research*

***Historical P/E & P/BV multiples pertain to respective year-end prices, while those for future years are based on closing prices on QE of 22nd July, 2010.*

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Company	Recommendation	Ticker	Price	Disclosure
Qatar National Bank	BUY	QNBK.QD QNB QA	QR 155.5	1,10

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Global Investment House
Website: www.globalinv.net
Global Tower
Sharq, Al-Shuhada Str.
Tel. + (965) 2 295 1000
Fax. + (965) 2 295 1005
P.O. Box: 28807 Safat, 13149 Kuwait

Research
Faisal Hasan, CFA
(965) 2295-1270
fhasan@global.com.kw

Index
Rasha Al-Huneidi
(965) 2295-1285
huneidi@global.com.kw

Brokerage
Fouad Fahmi Darwish
(965) 2295-1700
fdarwish@global.com.kw

Wealth Management-MENA & Far East
Fahad Al-Ibrahim
(965) 2295-1400
fahad@global.com.kw

Wealth Management - Kuwait
Rasha Al-Qenaei
(965) 2295-1380
alqenaei@global.com.kw

Global Kuwait
Tel: (965) 2 295 1000
Fax: (965) 2 295 1005
P.O.Box 28807 Safat, 13149 Kuwait

Global Bahrain
Tel: (973) 17 210011
Fax: (973) 17 210222
P.O.Box 855 Manama, Bahrain

Global Dubai
Tel: (971) 4 4477066
Fax: (971) 4 4477067
P.O.Box 121227 Dubai,UAE

Global Abu Dhabi
Tel: (971) 2 6744446
Fax: (971) 2 6725263/4
P.O.Box 127373 Abu Dhabi, UAE

Global Saudi Arabia
Tel: (966) 1 2199966
Fax: (966) 1 2178481
P.O. Box 66930 Riyadh 11586,
Kingdom of Saudi Arabia

Global Qatar
Tel: (974) 4967305
Fax: (974) 4967307
P.O.Box 18126 Doha, Qatar

Global Egypt
Tel: (202) 24189705/06
Fax: (202) 22905972
24 Cleopatra St., Heliopolis, Cairo

Global Jordan
Tel: (962) 6 5005060
Fax: (962) 6 5005066
P.O.Box 3268 Amman 11180,
Jordan

Global Wealth Manager
E-mail: contactus@global.com.kw
Tel: +965 1 (804242)

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