SHUAACAPITAL PSC

Ahli United Bank (AUBB.BH)

Equity Research — Initial Coverage

April 26th, 2006

Current Price:	USD 0.86	**Country:**	Bahrain
Fair value Target:	USD 1.30	**Sector:**	Commercial Banking
Recommendation:	BUY	**Exchange:**	Bahrain Stock Exchange

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- Ahli United Bank (AUB) is the second largest commercial bank in Bahrain in terms of assets. Through its subsidiaries and associates, AUB currently operates in Bahrain, Kuwait, Qatar, UK, and Iraq. It is also planning several expansions within the region.

- We expect AUB's consolidated profit to grow while assets quality and capital adequacy remain healthy. Due to limited information, our analysis does not include possible acquisitions which could impact the bank's value. Management's current focus on retail and private banking is expected to be the main driver for growth. In addition, the small market share outside of Bahrain provides AUB with an opportunity for further growth.

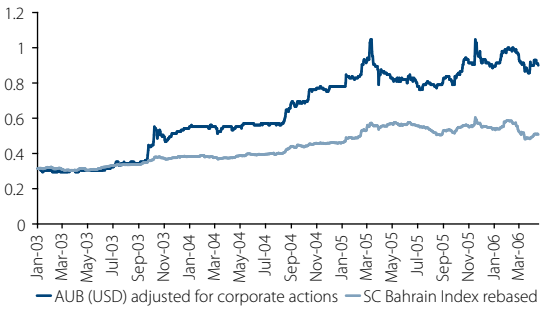
- We initiate coverage on AUB with a Buy recommendation since our target value of USD 1.30 per share is 51% above the recent price of USD 0.86 per share.

Year	Net profit (USD' 000)	BV (USD' 000)	EPS (USD)	BVPS (USD)	RoAE (%)	P/E (x)	P/BV (x)
Dec-08E	370,384	1,843,675	0.14	0.68	21.2	6.3	1.3
Dec-07E	322,486	1,658,484	0.12	0.61	20.4	7.3	1.4
Dec-06E	275,886	1,497,240	0.10	0.55	19.3	8.5	1.6
Dec-05	164,865	1,367,618	0.06	0.50	13.9	14.2	1.7

52-week range (USD)	0.76 - 1.05
Number of shares (000')	2,730,000
Free Float (%)	31
Market cap (BHD' 000)	884,956
Market cap (USD' 000)	2,347,800
Div. Yld. 2005 (%)	4.1%

Source: Reuters, SHUAA Capital

AUB stock performance vs. SC Bahrain Index



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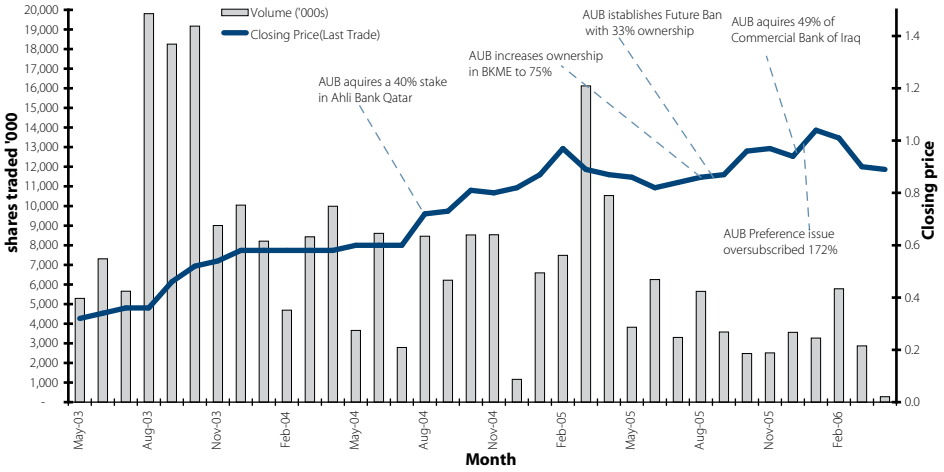
Investment Highlights

• Ahli United Bank (AUB) provides exposure to the banking sector in the GCC countries of Bahrain, Kuwait and Qatar. It also has exposure to the UK through AUB UK which focuses on private banking and wealth management. Overall, the bank's focus is on retail and private banking. In Bahrain, the bank operates the third largest retail operation in the country. In Kuwait, the bank operates through Bank of Kuwait and the Middle East, of which it owns 75%. The acquisition of a majority holding in BKME during 2005, resulted in a significant improvement in AUB's consolidated RoAE from 13.9% in 2005 to 17.9% in Q1 2006. RoAE is expected to reach 19.3% in 2006. Higher RoAE is partly due to the use of non-equity based funding to finance the acquisiton. In Qatar, it operates through Ahli Bank Qatar, of which it owns 40% and has a management contract. AUB's market share In Kuwait and Qatar is smaller than its share in Bahrain, where there is more room for growth.

• AUB is a consolidator within the GCC with a focus on the smaller banking markets. It creates value to its banking subsidiaries by providing experienced management expertise, multi market distribution of differentiated products, country diversification, and brand management. It currently has major operations in four separate markets with plans to expand into the remainder of the GCC as well as Iran, Iraq, Lebanon, Egypt, and Switzerland. This is to be achieved mainly through mergers and acquisitions, but also through organic expansion. Future capital increases are therefore expected in order to continue with the acquisition strategy. Regarding the GCC specifically, management has a long term objective of a 10%-20% market share in the countries in which the bank operates.

• The bank's long-term default rating by Fitch is BBB+ with a stable outlook. In our analysis and valuation we did not incorporate possible acquisitions by AUB. Acquisitions are part of AUB's strategy and are therefore likely within our projected period. However, due to lack of specific information, possible acquisitions were not incorporated.

• We used two valuation methods to estimate a market value for AUB's equity. We used a discounted equity cash flow and a relative valuation. Our analysis yielded a value of USD 3,543 mn or USD 1.30 per share. The DECF for AUB resulted in a valuation of USD 3,373 mn or USD 1.24 per share derived from a sum of parts valuation. We valued its consolidated operations separately from the bank's associates. Our second valuation is based on a regression of the price to book multiple of a peer group against forward RoAE. The relative valuation of AUB resulted in a value USD 3,940 mn or USD 1.44 per share.



Overview of Ahli United Bank (AUB)

Ahli United Bank (AUB) results from the April 2000 merger between United Bank of Kuwait (UBK) and Al-Ahli Commercial Bank (ACB). UBK was a London-based bank established in 1966 to serve Gulf interests in the UK; ACB was a major Bahraini commercial Bank since its incorporation in 1977. By May 2001, the newly created AUB had acquired a local Bahraini Bank, the Commercial Bank of Bahrain, and merged it with its own Bahraini operations (hitherto ACB) and re-branded the combined operation as Ahli United Bank. The UK unit (hitherto UBK) was re-branded as Ahli United Bank UK (AUB UK) in 2003.

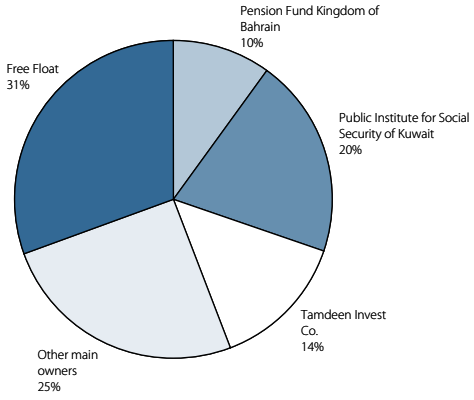
Further expansion into neighboring Kuwait occurred in 2002, with the acquisition of a 48% stake in the Bank of Kuwait and the Middle East (BKME). That stake was increased to 75% in August 2005. AUB also entered the Qatari market in August 2004 by acquiring a 40% stake in Ahli Bank of Qatar (ABQ) through a capital increase. Though this latter stake is not controlling, it does involve a 10 year (renewable) management contract to manage ABQ's operations. Lastly, AUB established 'Future Bank' in October 2004 in equal partnership with Bank Melli and Bank Saderat Iran, with a USD 99 mn paid-up capital.

As of today, AUB has 58 branches, and employs about 1,758 employees.

AUB has been aggressive at acquiring other banks

AUB's aggressive acquisition based growth strategy makes it one of the region's main consolidators in the commercial and retail banking sectors. This growth strategy has been successful due to strong shareholders support in funding expansion and in the subscription to several capital increases. AUB's main shareholders are (1) The Public Institute for Social Security of Kuwait with 20%, (2) Tamdeen Invest Co with 14%, and (3) the Pension Fund Kingdom of Bahrain with 10%.

Ownership structure



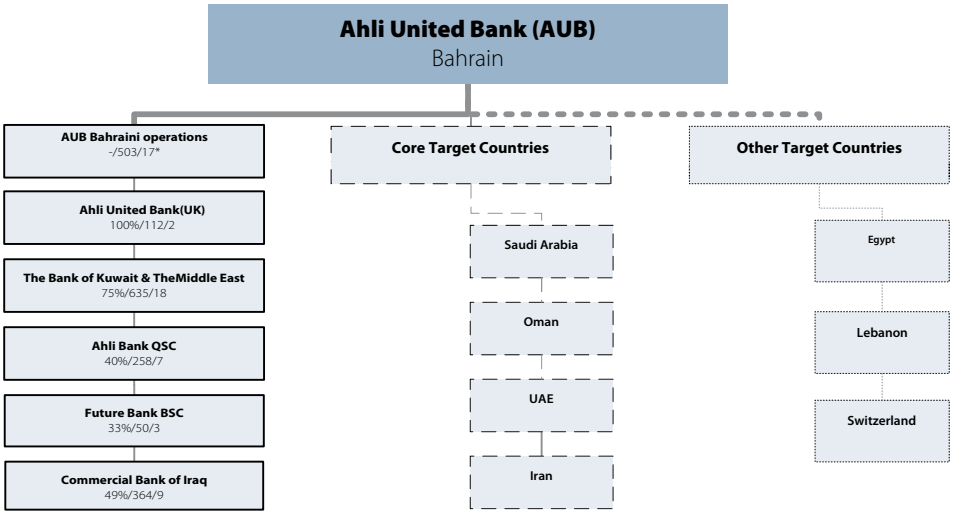
Source: AUB

AUB's strategy

AUB's strategy has two main components, one strategic and the other operational. The strategic aspect is a focus on regional expansion aimed at creating an immediate and significant presence in key markets, rather than traditional branch expansion. AUB currently operates in Bahrain, Kuwait, Qatar and the UK, but plans to enter Iran, Iraq, Lebanon, Egypt and Switzerland, in addition to the remainder of the GCC. We therefore expect capital increases to continue as a means of funding future potential acquisitions.

AUB has the third largest retail operation in Bahrain

Management has stated that it aims at a 10%-20% market share in every GCC country in the long-term. AUB is also keen to strengthen its position in the home market, Bahrain. AUB has the third largest onshore operation in Bahrain, and plans to further strengthen its position in the market.



* (percent ownership/number of employees /number of branches)

Source: AUB

AUB plans to focus on retail and private banking

The second component of this strategy is an operational focus on retail and private banking operations, which should consolidate its position. Retail and Private banking accounted for 40% of operating results in 2005, up from 37% in 2004, but against a stated target of 50%. Achieving this will depend in part on successful expansion into new retail markets, and in part on the successful development of new product lines. AUB currently uses its UK subsidiary to source products that are distributed throughout the group. We therefore expect an increased emphasis on new product development from the UK subsidiary as a means to better serve existing customers, attract new ones, and increase fee income.

Rating

AUB has obtained high financial strength ratings on long-term default. The bank's regional diversification as well as strong backing from major shareholders helped lower its risk level.

	Rating	Outlook
AUB long-term default rating - Fitch	BBB+	Stable
AUB UK long-term default rating - Fitch	BBB+	Stable
BKME long-term default rating - Fitch	BBB+	Stable

Source: Fitch Ratings

AUB's functional segments

AUB is broken down into three functional divisions: retail banking, private banking & wealth management, and corporate banking & treasury

AUB is organized into three business divisions: (1) retail banking, (2) private banking & wealth management, (3) corporate banking & treasury. IT, risk management, operations and finance operate as a separate, shared, central unit. Retail banking is essentially based in Bahrain, Kuwait and Qatar. It accounted for 33.4% of segment results in 2005 with a RoAA of 3.8%. The customer deposit base, which is dominated by retail accounts, amounts to nearly 50% of sources of funds. These tend to be stable, low-cost deposits.

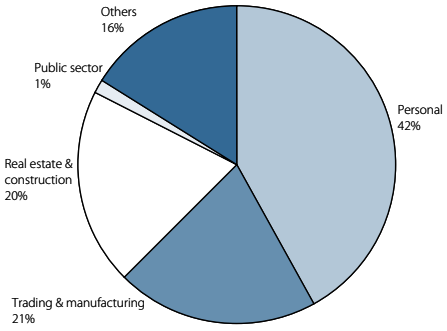
Private banking & wealth management is largely off-balance sheet and fee generating. The division accounted for 6.9% of segment results in 2005, with a RoAA of 3.2%. In addition to traditional products, this division provides real estate fund-management and Islamic banking services. AUB UK is the source of most of the group's products, though AUB also sells funds for Mellon Global Investors and Henderson Global Investors. AUB recently received the award for 'best local private bank' in the region by Euromoney.

The corporate banking & treasury covers corporate and trade finance, property finance, structured finance, and treasury services. It accounted for 59.7% of segment results in 2005 by managing USD 7,952 mn in assets. The segment's RoAA is 1.33%. The corporate and trade finance is operated out of London and Bahrain with an international orientation. Property finance provides products for investors and developers covering commercial office, retail, industrial and residential markets in the UK and GCC. Structured finance, established on June 2000, is focused on the management buy-out market in Europe. Finally the treasury services handle most of AUB's funds through Bahrain and London. In terms of asset allocation, management is not planning and does not foresee any major shift in allocations from current levels.

AUB's exposure by sector

The bank's largest lending category is personal lending, representing 42% of all loans. The next two categories, real estate & construction, and trade & manufacture, amount to 20% and 21% respectively.

Clasification of loans by sector (2005)

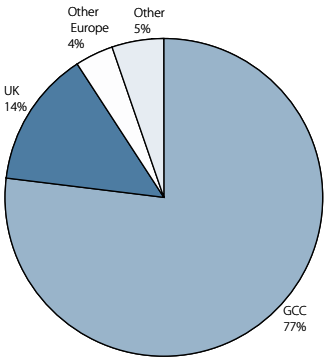


Source: AUB

AUB's regional segments

AUB's highest exposure is to the GCC, in particular in terms of sources of funds and loan exposure. Exposure is also high from Europe & UK. Other countries, including non-GCC Arab countries, account for only 5% of loan exposure.

Geographical classification of loans (2005)



Source: AUB

Bahrain is AUB's strongest market

AUB Bahraini operations

The bank began its operations in Bahrain in December 1977, and only took over the Commercial Bank of Bahrain in 2001 following its merger with UBK. AUB commands third place in retail banking behind the National Bank of Bahrain and the Bank of Bahrain and Kuwait. Although Bahrain is the smallest of the GCC market for retail banking, it is AUB's strongest market. AUB benefits locally from a strong retail presence and healthy interest margins. It operates 17 branches in the Kingdom, the third largest branch network, with approximately one branch per 43,300 persons.

AUB UK provides a differentiated product line compared to GCC competitors

AUB UK

AUB UK is a fully owned subsidiary of AUB. It provides private banking & wealth management services to GCC customers, as well as some Islamic banking products and real estate services. Specifically, AUB UK is active in the provision of significant commercial real estate loans in the high-end London real estate market. AUB UK has two branches, one in London, and one in Guernsey, in addition to a representative office in Kuwait. On the asset front, most of AUB's European exposure comes from AUB UK. As previously mentioned, AUB UK is the principal source of financial products for the AUB network. This enables AUB to offer a more diverse range of products than some of its competitors. AUB as a whole managed USD 4.48bn in assets under management (AUM) on behalf of its clients, of which a substantial amount relates to AUB UK's products.

Ahli Bank Qatar (ABQ)

AUB entered the Qatari market by purchasing 40% of Ahli Bank in Qatar in 2004. AUB also received a 10 year management contract that allows it to exercise extensive control over the bank. It operates seven branches with a focus on expanding the retail business. The bank has USD 1,698 mn in assets, USD 1,244 mn in deposits and USD 959 mn in loans. It is currently the smallest of the four local commercial banks. It accounts for 6.6% of assets and 6.9% of deposits in Qatar. In 2005, the bank had USD 38.9 mn in profits, a RoAE of 14.8% and a RoAA of 2.71%.

Bank of Kuwait and the Middle East (BKME)

AUB acquired a first stake of 15% in BKME in 2001, which it then increased to 48% in 2002. That stake was increased to 75% in August 2005. BKME's shares are still traded on the Kuwait Stock Exchange. With the fourth largest branch network (18 branches), BKME holds USD 5,520.5 mm in total banking assets, and USD 3,215.7 mm in deposits, putting it in sixth place in terms of market share. In line with AUB's overall strategy, BKME is increas-

ingly focusing on its retail business. Its retail & commercial banking currently accounts for 71.5% of total revenues, whilst treasury and investments account for the remaining 29.5%. BKME hopes to increase its market share significantly by 2008, from its current 10% of total assets. Achieving this will be difficult, however, in light of dominance exerted by bigger banks such as NBK and the cooling stock market. In 2005, the bank reported profits of USD 136.7 mm, representing a RoAE of 20% and a RoAA of 2.4%.

BKME owns asset manager and broker KMEFIC

BKME owns 50.14% of Kuwait & Middle East Financial Investments Company (KMEFIC), which is also listed on the Kuwait Stock Exchange. KMEFIC operates as an asset manager for clients, via its own funds, and as a broker (including online). Moreover, KMEFIC provides investment advice and funds for equity, real estate, and venture capital in both regional and international markets. As of September 2005, it ranked seventh in Kuwait in terms of AUMs.

Future Bank

AUB established Future Bank in 2004 through an equal partnership with two Iranian banks, Bank Melli and Saderat Iran. With a paid-up capital of USD 99 mm, Future Bank has three branches in Bahrain, and plans to expand into Qatar, Oman and the Iranian island of Kish. Its purpose is activity on trade and finance deals between Iran and the GCC. Future Bank is regulated by the Bahrain Monetary Agency.

Commercial Bank of Iraq

The Commercial Bank of Iraq was established in 1992 to focus on the Baghdad area. AUB acquired a 49% stake in the bank in 2005 through a capital increase, from USD 9.6 mn to USD 43.7 mn. As of June 2005, Commercial Bank of Iraq had USD 89 mn in total assets and generated profits of USD 1.28 mn. The bank has eight branches in Baghdad and one in Basra, and some 364 employees. AUB plans to align the Commercial Bank of Iraq's strategy to its own group strategy, but pending improvements in the security situation, planning in any detail is unlikely.

Analysis and Forecasts

Analysis does not incorporate possible acquisitions

Though AUB's strategy is explicitly growth-focused and acquisitions-based, we will concentrate on its existing businesses in order to value the bank. As such, we will limit our analysis to separate assessments of AUB Bahrain & UK, Bank of Kuwait and the Middle East (BKME) and Ahli Bank Qatar (ABQ). Before going into the analysis and forecasts for each segment we will present a sector presentation on the relevant market. In our view, senior management's efforts to align local and group strategies does add value, as does the common product base emanating from AUB UK. Accordingly, we have incorporated this added value in each firms' assessment.

Development and Integration of GCC Banking to Drive Growth

The GCC banking sector is evolving rapidly. The main trends are favorable economic conditions, increased competition and diversification of products, as well as regional expansions by the major banks. These trends are also the primary drivers for AUB's growth. Furthermore, the increasing control of AUB's senior group management on its subsidiaries (at ABQ since 2004 and at BKME since 2005), primarily with regards to the implementation of a coherent strategy and in general management improvements, is expected to yield further improvements in the group's performance.

Yet there are some concerns: AUB's size makes it a medium-to-bottom tier player in each of its markets. This will constrain its ability to grow spreads. While interest rates declined between 2004 and 2005, rising rates in 2006 would force AUB's subsidiaries to compete for deposits with higher rates, while larger banks such as NBK expand their interest spreads. This concern is compounded by the increased volatility of regional stock markets, which among other unwanted effects, is expected to increase the number of NPLs in most banks.

Overview of the Bahraini Banking Sector

Bahraini Economic and Political Environment

As of 2004, Bahrain's population was 740,000 and its per capita GDP was USD 13,950. Bahrain is among the least oil-dependent countries in the GCC, with the oil sector accounting for 25% of GDP in 2003. The service sector, dominated by tourism and banking, is of particular importance, as is aluminum production. Bahrain is a major regional banking hub with 362 financial institutions and 24 commercial banks. There is also a significant presence of offshore and Islamic banks.

Bahrain is a major financial center

Initiatives for economic growth are focused on non-oil sectors such as real estate, banking and aluminum. For example, the government-controlled aluminum producer, ALBA, plans to increase its production to 1.1mn tons per annum by 2010, up from the current 600,000 tons. With regards to banking, the government is targeting offshore and Islamic banking in particular, as the strong performance of regional markets and high levels of liquidity have already led to considerable growth in traditional banking. The real estate sector is also booming, with major projects in real estate and infrastructure such as the USD 1.3 bn development of the Bahrain Financial Harbor. GDP is expected to grow by 5.6% in 2006 and 5.4% in 2007, compared with about 6.4% for 2005.

Bahrain basic information	2003	2004	2005 E	2006 F
Population (mn)	0.7	0.7	0.7	0.8
GDP (USD bn)	9.66	10.9	11.57	12.07
Real GDP growth (%)	7.3	5.4	6.4	5.6
Current account (% of GDP)	2.1	3.8	11.8	8.9
Budget Balance (% of GDP)	-3.1	2.4	4.4	0.2

Source: EIU, BMI

The Bahraini government is generally more fiscally prudent than its GCC counterparts. According to the Economist Intelligence Unit (EIU), the Government is expected to register a fiscal surplus of USD 400 mn in 2006 and a small deficit of USD 200 mn for 2007. We do not foresee any serious political risks in the country other than the general political risk of the region. The Bahrain Monetary Agency is well respected and competent. It is a major driving force behind the financial sector's development. The Bahraini Dinar is pegged to the US dollar (USD 1.0 = BHD 0.376). Monetary policy and interest rate strategy are based on that of the US Federal Reserve. The economy is experiencing an increase in liquidity. However, this has not had the same effect as in other GCC countries. Inflation is expected to be 2.9% for 2006 according to the EIU, and Bahraini listed firms trade at a discount relative to the other GCC markets.

Country credit rating	Moody's
UAE	A1
Qatar	A1
Kuwait	A2
Saudi Arabia	A3
Bahrain	Baa1
Oman	Baa2

Source: Moody's

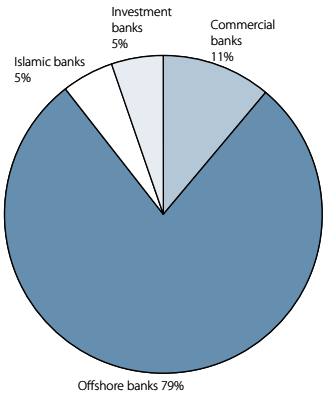
Banking Overview & Profitability

Commercial banking assets grew by 18% in 2005

Total banking assets grew from USD 118.9 bn in 2004 to approximately USD 140.4 bn in 2005, an increase of 18%. This includes a large amount of offshore and Islamic banking assets, which we will not discuss in this report, as we are concerned only with commercial banking, which accounts for approximately USD 16.5 bn, or almost 11% of 2005 figure.

The market is highly developed, as can be seen with the high loans to private sector over GDP ratio, relative to regional peers (see chart below). This ratio is expected at around 60% for 2005, compared with 55% in Kuwait and 51% in Qatar. This ratio is high if we consider that Bahrain's equity market and real estate sector have not generated the kind of exuberant borrowing that characterized the markets of Kuwait, Saudi Arabia and the UAE over the past year. Reasons for this relate to the banking sector's relative maturity, and to Bahrain's economy being more diversified than that of its regional peers, which translated into more varied lending opportunities. Case in point, the expected 2005 RoAE of the five listed commercial banks is 10%; well below Kuwait's 26.8% and Qatar's 23.3%. Structurally, this has to do with the size of the market: Bahrain is a smaller market with limited economies of scale and intense competition between commercial banks, Islamic banks and international banks. On fundamentals however, we see this as an indication that earnings have not been overinflated by investment gains and intense IPO activity, as has been the trend regionally.

Total Banking Assets



Source: BMA,

Bahraini Commercial Banks	2003	2004	2005 E
Bank deposits/GDP	85%	81%	90%
Loans to the private sector/GDP	48%	53%	60%
Assets/GDP	126%	134%	143%
Deposits growth	12%	9%	18%
Loans growth	9%	24%	21%
Loans/deposits	57%	65%	67%

Source: BMA, EIU, SHUAA Capital

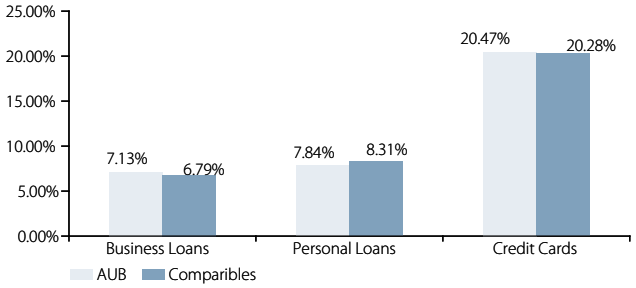
Competitive Environment

Top three banks dominate retail banking

Bahrain's top three commercial banks dominate the retail banking sector. In order of size (by branch network), these are (1) National Bank of Bahrain (NBB), (2) Bank of Bahrain and Kuwait (BBK), and (3) AUB. The 21 other commercial banks (including foreign banks) share the rest of the market. As previously noted, Bahrain's small size and open market enables foreign banks to service clients effectively with small branch networks.

As of December 2005, AUB's rates were more competitive than the market on personal loans, though they charged higher rates on credit cards and business loans. Interest charges on business loans exhibited a wide range between banks, from 5.79% to 12.16%, as they attempted to differentiate themselves from competitors. Personal loans' interests exhibit a similar trend, ranging from 7.50% to 14.39%. Credit cards were the most competitive segments, with interest rates ranging only 4%, from 17% to 21%. This is due in part to less competition from foreign players with specific exposure targets.

Interest rates on loans (Dec. 2005)



Source: BMA

Banking Regulation

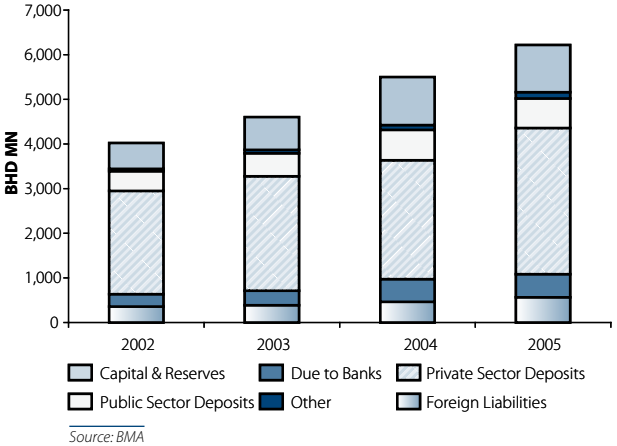
The Bahraini Monetary Agency, which regulates the banking sector, is among the more efficient regulatory bodies in the GCC. Since the Bahraini Dinar is pegged to the US dollar, the Agency's interest policy follows that of the US Federal Reserve. As a result, the Agency is able to focus on regulating and developing the banking sector. For an overview of some of the main banking regulations, please refer to Appendix 1.

Sources of Funds

GCC and other Arab countries accounted for more than half of foreign liabilities

For 2005, the commercial banking deposits to GDP ratio is estimated at around 90%, compared to 81% in 2004. Essentially, this is the result of foreigners depositing funds in Bahrain. There are a number of reasons for this, including the high credibility of the regulatory authorities. Despite a decrease in the proportion of deposits to total sources of funds, from 57.5% in 2002 to 52.7% in 2005, foreign liabilities have increase from 14.4% to 17% during the same period. Arab and GCC countries accounted for more than half of total foreign liabilities. Capital and reserves, at 9.09% at the end of 2005, remain largely unchanged from previous years.

Sources of Funds



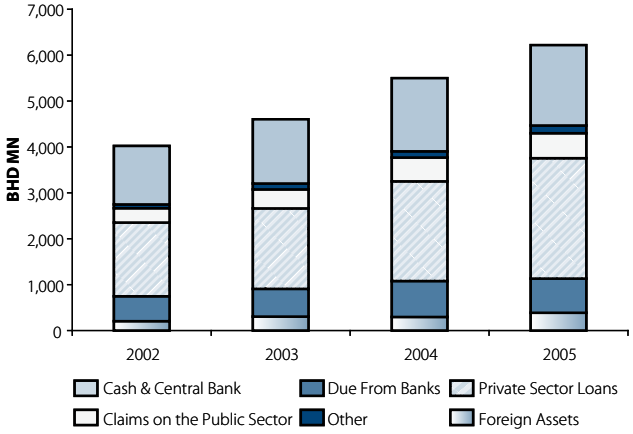
Source: BMA

Uses of Funds

Asset allocations has been shifting towards loans

Total assets increased by a compounded annual growth rate (CAGR) of 18.2% between 2002 and 2005 while asset allocation has been shifting towards loans. Foreign assets as a percent of total assets have declined gradually from 34.1% in 2000 to 28.2% by end of 2005. Due from banks also declined. On the other hand, loans have increased as a proportion of total assets, from 39.95% to 42.19% and 7.15% to 8.74%, between 2002 and 2005 respectively.

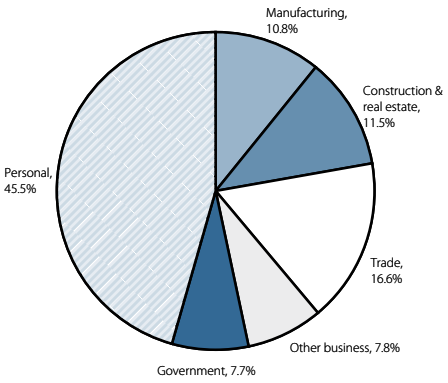
Uses of Funds



Source: BMA

In the lending sector, personal loans accounted for the bulk of activity as at end of 2005, with 45.5% of total loans. Other categories include trade financing (16.6%) and loans to the Government (7.7%). Significantly, a major shift in allocation occurred in real estate: lending increased by 37% during 2005, reaching 11.5%, up from 8.4%.

Banking industry loans by economic sector (Dec. 05)



Source: BMA

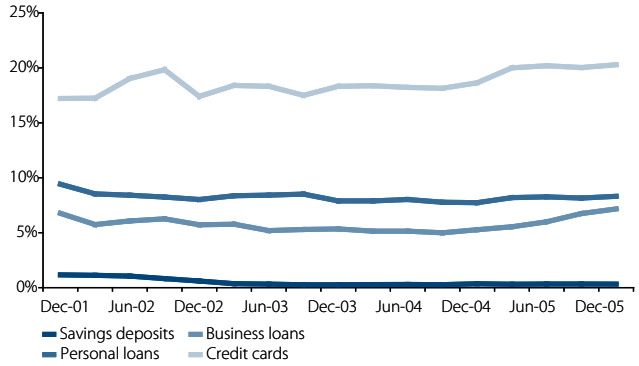
Interest Rates

Interest rates on the rise

As previously mentioned, the Bahraini Dinar is pagged to the US dollar, which means that Bahrain's monetary policy is closely aligned with the Federal Reserve's. The Fed has been raising rates from historical lows of 4.5% to about 5.5%, and a further increase of 50 basis points is expected in 2006. Bahraini banks are already raising interest rates on loans, while

maintaining them flat on saving deposits.
In 2005, rates on business loans increased by 36%, or 189 basis points, vs 2004. This hike was driven by lending in real estate & construction, which witnessed a rate increase of 63% for the year. Personal loans were up by 58 basis points or 7.50%, and credit cards were up 164 basis points, or 8.80%.

Commercial banks interest rates



Source: BMA

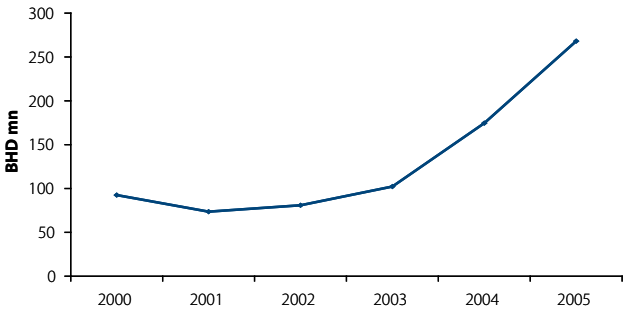
Islamic and offshore banking

Islamic banking assets witnessed a significant surge in 2005, up 47%, to reach BHD 8.0 bn. This compares with an annual growth rate of nearly 30% over the past four years. The sector is experiencing considerable activity. A new Islamic bank called Al Salam Bank was recently formed with a paid up capital of USD 318.4 mn; its IPO was oversubscribed 63 times. A new Sharia-compliant investment bank, 'Ithmaar Bank', is going public, targeting USD 360mn in new capital. Albaraka Banking Group is also planning an IPO in April in order to raise its capital from USD 550mn to more than USD 1bn, and at least one more Islamic bank is expected to IPO in the short term. Finally, plans were announced to create the largest Islamic bank in the world in terms of assets, with a paid-up capital of USD 10bn. This new bank, to be called 'Al Masraf Islamic Bank', is also set to IPO, though we are skeptical as to scale of the planned flotation. This flurry of IPO activity, coupled with the capital increases of existing Islamic banks, is certain to increase competition in the sector. We expect the sector to grow considerably, but the number of qualified experienced professionals looks set for a shortage.

Investment Banking

Investment banks increased their assets by over 24% in 2005, to BHD 7.7bn. In a similar tale to Islamic banking, that growth was higher than the average annual growth of the past four years, which was 16%. According to the BMA, the amount of cash invested in funds through investment banks as at 9M 05 was BHD 3.9bn, an increase of 55% on a comparable basis. According to BMA, the total amount invested in funds through investment banks at the end of 9M 05 was BHD 3.9 bn, an increase of 55% over the same time period during the previous year.

Value of shares traded on Bahrain Stock Exchange (BSE)



Source: BMA

Analysis and Forecasts for AUB Bahrain & UK

This section includes the analysis and forecasts for AUB's Bahraini and UK operations. AUB's Kuwaiti and Qatari operations are discussed in the following sections.

Sources of funds

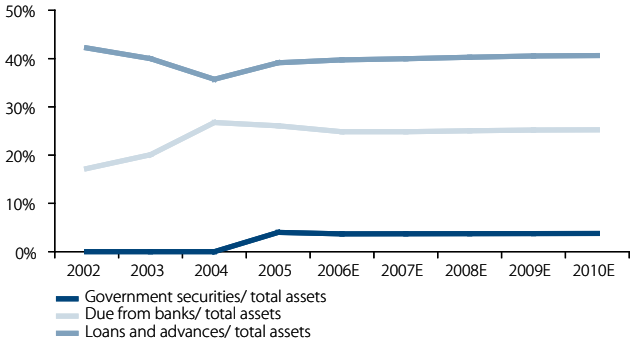
Since interest rates are expected to increase, growth in due to banks should be limited while AUB focuses on growing the more stable deposits. Due to banks over deposits should drop from 75% in 2005 to 73% by 2010. Deposit growth in 2006 is expected at 12% and a compounded annual growth rate (CAGR) of 8% through our forecast period. Overall interest bearing liabilities should grow by 11% in 2006 and have a CAGR of 7% through our projected period.

Uses of funds

No significant shift in asset allocation expected

Management has indicated that asset allocation should remain largely unchanged from current levels for its operations outside Qatar and Kuwait. In actual terms loans are expected to grow by 12% in 2006 and have a CAGR of 8% through the entire projection period. In relative terms we increased loans as a share of total assets to 39.7% in 2006 and 40.6% by 2010 compared to 39.1% in2005. This reflects managements focus on loans and the healthy lending environment expected in Bahrain and the UK. Due from banks as well as government securities are expected to remain similar to current levels relative to total assets.

Asset Allocation Shift



Source: AUB, SHUAA Capital

Interest income

With AUB Bahrain and AUB UK we assumed spreads to remain the same through the projected period. Increased competition and a focus on growing lending volumes will constrain the bank. General interest rates should go up due to central bank hikes. In addition the bank's brand image and service in Bahrain will allow it to sustain current spreads, which are already well below historical rates for the bank.

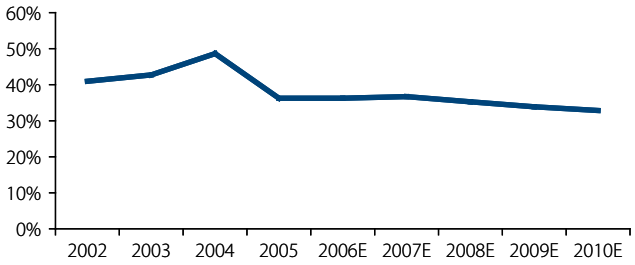
Spreads & margins	2002	2003	2004	2005	2006E	2007E	2008E	2009E	2010E
Average IEAs yield	4.71%	4.40%	4.06%	4.84%	5.24%	5.24%	5.24%	5.24%	5.24%
Cost of funds	2.76%	2.32%	2.15%	3.38%	3.78%	3.78%	3.78%	3.78%	3.78%
Spread	1.95%	2.08%	1.92%	1.46%	1.46%	1.46%	1.46%	1.46%	1.46%
Margin	2.14%	2.24%	2.00%	1.46%	1.46%	1.46%	1.46%	1.46%	1.46%

Source: AUB, SHUAA Capital

Non-interest income

Non-interest income reached 36.2% of total income in 2005 compared to 48.6% the year before. We are projecting a decline to 32.9% by 2010. However it will remain unchanged during 2006. This is due to an expected increase in the level of competition, as well as a drop in the contribution of trading & investment income relative to both interest income and fee income. In actual terms non-interest income should grow by a CAGR of 6% through our projected period. AUB UK also helps create non-interest income in Kuwait and Qatar, through the private banking and wealth management products that it provides. Therefore part of this value adding activating is incorporated into BKME and ABQ results.

Non-interest income / total income



Source: AUB, SHUAA Capital

Profit growth to remain strong

16% CAGR growth in profits expected through projected period

During 2006 profit should grow by 29% to USD 72 mn. AUB's profits from its Bahraini and UK operations should grow by a CAGR of 16% through our projected period. Non performing loans will increase marginally above current levels as a proportion of total loans, while we are assuming that provisioning as a proportion of non performing loans will remain the same.

Overview of the Kuwaiti Banking Sector

Banking Overview & Profitability

Banking sector assets grew by 13% in 2005

The banking sector's assets increased to KWD 21.6bn (USD 74bn) in 2005 from KWD 19.2bn in 2004, an increase of 13%. 2005 also saw loan growth outpace deposit growth. This is starting to raise the level of competition over deposit accounts, as many banks are close to the 80% loans to deposit limit set by the central bank. Nevertheless, the sector as a whole is thriving as a result of the oil boom's positive impact on public financing, real estate and capital markets. Profitability in the non-Islamic commercial banking sector increased from an aggregate of KWD 366.8mn at the end of 2004 to KWD 501.5mn in 2005, an increase of 37%. This implies a sector RoAE of 26.8% and a RoAA of 3.2%. On a quarterly basis however, net profits peaked in Q3 05 and fell by 7% in Q4 05 as deposit growth slowed and the real estate market cooled.

Kuwaiti Banking Sector	2003	2004	2005 E
Bank deposits/GDP	64%	52%	63%
Loans to the private sector/GDP	46%	42%	55%
Assets/GDP	112%	92%	101%
Deposits growth	4%	10%	25%
Loans growth	17%	23%	35%
Loans/deposits	72%	81%	88%

Source:CBK, EIU, SHUAA Capital

Competitive Environment

Top three commercial banks clearly outperform the other three in ROAE

Six local commercial banks operate in Kuwait, as well as one major Islamic bank (Kuwait Finance House). Foreign banks were allowed to enter the market only recently, and are restricted to one branch. Even with Kuwait's small population, the commercial banking sector is highly concentrated compared with regional peers such as Saudi Arabia and the UAE. Among the six local commercial banks, the National Bank of Kuwait (NBK) clearly dominates.

2005 Rank by assets (KWD 000's)	Total assets	Equity	Customer deposits	Loans
National Bank of Kuwait	6,200,322	656,627	3,956,523	3,363,654
Gulf Bank	2,608,241	303,590	1,829,001	1,578,565
Commercial Bank of Kuwait	2,342,739	376,086	1,287,324	1,173,143
Al Ahli Bank	2,007,656	236,708	1,394,851	1,132,242
Burgan Bank	1,889,712	247,300	1,166,645	799,805
Bank of Kuwait and the Middle East	1,611,972	204,917	938,997	757,827

Source:: Company financials

As the below chart makes clear, Kuwaiti banks can easily be divided in two groups by the size of their assets, the top three banks being far larger than the bottom three. This can also be seen in RoAE's, which range between 27% and 34% for the three larger banks, versus 18% to 21% for the smaller ones. The three larger banks tend to operate in a less competitive environment, as they have benefited from greater economies of scale and strong franchise names to maintain superior profitability ratios. The smaller banks, on the other hand, have competed with lower loan rates and high deposit rates. Kuwait's positive economic cycle has somewhat lessened competitive pressure over market share for the smaller banks, as lending opportunities have increased in line with economic growth. As a result, smaller banks have actually shown faster profit growth than larger ones. BKME, for example, as the smallest bank, has enjoyed the second highest growth rate in profits.

2005 Rank by assets (KWD 000's)	Net profit	Net profit growth	RoAE	RoAA	Cost-to-income	Interest spread
National Bank of Kuwait	205,612	37%	34%	3.5%	31%	4.1%
Gulf Bank	85,370	14%	30%	3.5%	34%	3.8%
Commercial Bank of Kuwait	81,159	30%	27%	3.9%	30%	4.2%
Al Ahli Bank	47,023	73%	21%	2.5%	37%	3.2%
Burgan Bank	42,384	43%	18%	2.3%	37%	3.0%
Bank of Kuwait and the Middle East	39,919	75%	20%	2.4%	37%	2.8%

Source:: Company financials

Banking Regulation

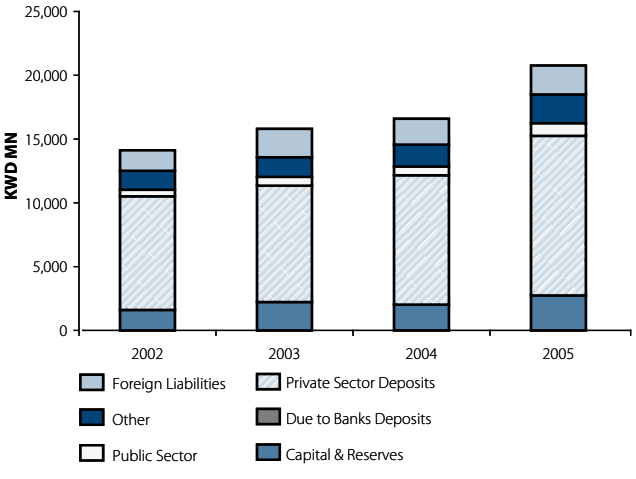
The Kuwaiti banking sector is regulated by the Central Bank of Kuwait (CBK). The Kuwaiti Dinar is pegged to the US dollar, and as in Bahrain, monetary policy is closely aligned with the US Federal Reserve. In 2005, CBK allowed foreign banks back into Kuwait after numerous years of absence. Some of the main banking regulations of Kuwait are outlined in Appendix II.

Sources of Funds

Private sector deposit's share of total sources of funds fell in 2005

Banking sector deposits to GDP for 2005 are estimated at 63% compared to 55% the previous year. The ratio improved significantly as deposits grew by 25% during the year. Within deposits, private sector deposits fell from 59.02% of total assets to 57.87% between 2002 and 2005, while public sector deposits grew by about the same amount, from 3.39% to 4.61%. This has been driven primarily by the improved financial position of the public sector and extra spending as a result of the oil boom. Capital has also increased as a funding source to 12.69% from 11.3%, as banks took advantage of flush liquidity and carried out several capital increases.

Sources of Funds



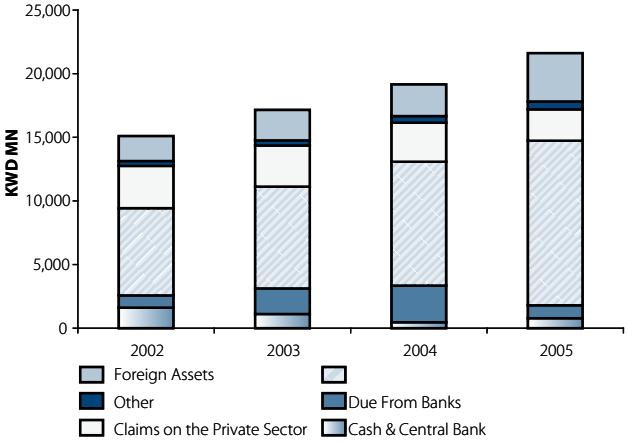
Source: CBK

Uses of Funds

Asset allocations shift towards foreign assets and private sector loans

A slight shift has taken place in asset allocation, towards claims on the private sector and foreign assets. As a percentage of total assets, allocation to foreign assets increased from 12.9% in 2002 to 17.6% in 2005. We believe that this is due to the banks inability to fully utilize the excess liquidity created by the oil boom in the local economy. Claims on the private sector increased by 33% in 2005, compared to a CAGR rate of 21% between 2002 and 2004. Within claims on the private sector, credit facilities to residents increased from 40.2% of total assets in 2002 to 54.7% in 2005. Other categories in uses of funds were either flat of declining during the same period.

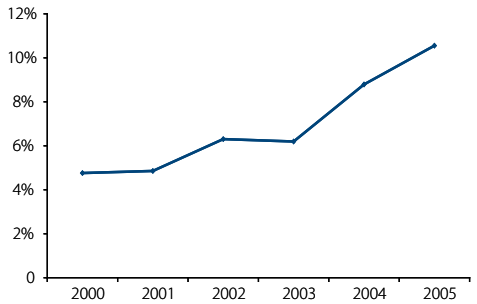
Uses of Funds



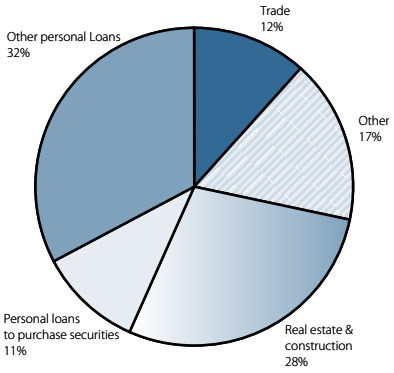
Source: CBK

Credit facilities increased thanks to significant borrowing in the real estate & construction sector and in personal loans to purchase securities. This is linked to high oil prices and generally favorable macroeconomic conditions, which have improved Kuwait's risk profile significantly. As a proportion of total loans, real estate & construction loans increased from 24.5% in 2002 to 28.5% in 2005. The share of personal loans to purchase securities grew even faster, reaching 10.55% in 2005. This increase in the level of securities-related exposure by banks will have a negative impact if and when securities performance decline.

Personal loans to purchase securities/total loans



Distribution of loans by sector



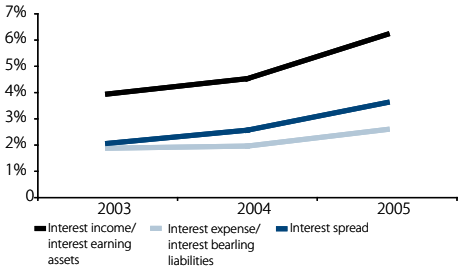
Source: CBK

Interest Rates

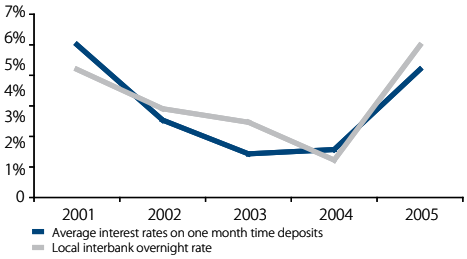
Interest spread improved in 2005

Like Bahrain, Kuwait's interest rates are driven by the US Federal Reserve, and we expect them to increase in the same fashion. As can be seen below, interest rates have been on the rise in 2005 and are expected to maintain that trend through 2006. The 20% reserve requirement on customer deposits has been a determining factor of competition among banks by forcing them to compete by increase rates on deposits to increase lending, while maintaining adequate reserves. This is especially true for smaller banks, as they tend to be close to their lending limit and to compete on rates rather than franchise reputation. The overall interest rate spreads of Kuwaiti commercial banks increased from 2.1% in 2003, to 3.6% in 2005. While the three larger banks managed to leverage their franchise names to achieve spreads between 3.8% and 4.2%, the three smaller banks performed at lower levels, with spreads ranging from 2.8% to 3.2%.

Commercial banking interest spreads



Banking interest rates



Source: CBK

Quality of Assets & Capital Adequacy

High asset quality and sufficient capital adequacy

In 2003, non-performing loans (NPLs) represented 4.7% of commercial banks' gross loans. That figure increased to 5.5% in 2004, following a correction on the Kuwait Stock Exchange, which had rallied after the invasion of Iraq. By the end of 2005, NPLs stood at a more reasonable 3.5%. Yet the possibility of increasing NPLs due to market corrections remains serious, given the large bank exposure to loans for the purpose of buying securities. Loan-loss provision as a proportion of NPLs remained flat in 2005, at 78%.

Generally speaking, Kuwaiti banks are in a better position than their GCC peers regarding the quality of their assets. Capital adequacy has improved from 15.2% in 2003 to 17.3% in 2005. This is due to several capital increases by the banks, supported by high liquidity and strong retained earnings. All banks are currently compliant with the central bank requirements regarding capital adequacy.

Investment Banking

As of September 2005, total AUMs stood at approximately USD 46.4bn; a 60% increase over the comparable period. Investment banking in Kuwait is among the more developed within the GCC. In asset management, there are no less than 20 well established fund managers, offering a diverse range of investment products. For more detail on this subsector, kindly refer to our recent report on Kuwait Financial Center (Markaz).

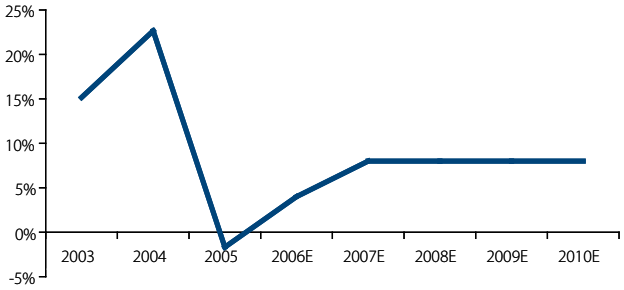
Analysis and Forecasts for BKME

Customer deposits fell by 1.7% in 2005

Sources of funds

Both customer deposits and due to banks fell during 2005 by 1.7% and 3.7%. This took place while the overall banking sector in Kuwait grew deposits by 25%. This is partially because the bank was more focused on achieving a higher spread on deposits rather than on competing for a greater amount. Looking forward, BKME's loan growth will be liimited by its ability to grow deposits, as the bank is currently close to the central bank lending limit of 80% of deposits. Therefore, deposit growth should pick up as it will become a more important focus of management. We are projecting deposit growth of 15% in 2006 and 8% thereafter. Competition from the bigger banks and and slower economic growth beyond 2006 should be the primary constraints on deposit growth.

Customer deposit growth

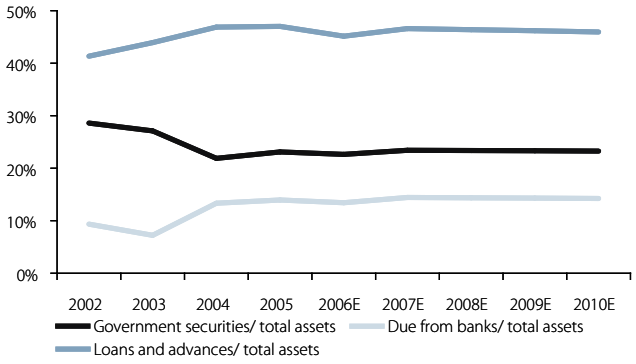


Source: BKME, SHUAA Capital

Uses of funds

Between 2002 and 2004, as the bank shifted its focus on retail banking, it shifted assets away from government securities to loans as well as due from banks. By 2005, loans accounted for 47.0% of assets while government securities and due to banks accounted for 23.1% and 13.9%, respectively. AUB's management is currently not planning any major shifts in allocation. We therefore kept asset allocation stable at current levels.

Asset Allocation Shift



Source: BKME, SHUAA Capital

Interest income

Spreads to drop slightly in 2006

As discussed in the banking sector overview we expect the US Federal reserve to raise rates by 50 basis points. Therefore it is expected that average yields on interest earning assets (IEAs) increase by 45 basis points during 2006. On the other hand we expect a slightly higher increase of 50 basis points in the cost of funds. This is because the main source of funds 'deposits' has not increased as fast as the general rise in interest rates. Therefore we believe deposit rates will start playing catch up with the other rates. In addition, BKME will need to more aggressively compete for deposits forcing it to lift its rates. We assumed spread to remain stable after 2006.

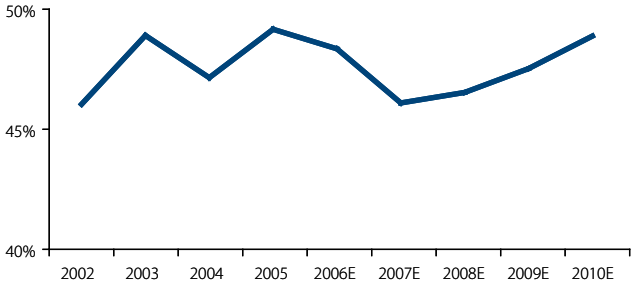
Spreads & margins	2002	2003	2004	2005	2006E	2007E	2008E	2009E	2010E
Average IEAs yield	3.98%	3.86%	4.13%	5.14%	5.59%	5.59%	5.59%	5.59%	5.59%
Cost of funds	2.43%	2.06%	2.16%	2.77%	3.27%	3.27%	3.27%	3.27%	3.27%
Spread	1.55%	1.80%	1.97%	2.37%	2.32%	2.32%	2.32%	2.32%	2.32%
Margin	1.50%	1.75%	1.96%	2.37%	2.32%	2.32%	2.32%	2.32%	2.32%

Source: BKME, SHUAA Capital

Non-interest income

Non-interest income increased substantially in 2005. This is partly due to improvements in the retail and private banking businesses, and partly due to KMEFIC. The majority of KMEFIC's income comes from non-interest fee and investment income. Non-interest income amounted to 49% of total income in 2005. For 2006, we anticipate a drop in non-interest income to total income, primarily in investments, due to volatile markets and heightened competitive pressures. We therefore increased non-interest income from KWD 36.7mn in 2005 to KWD 38.8 mn for 2006, an increase of 5.7%. By the end of 2006, non-interest income should fall to 48.3% of total income, and increase again slightly to 48.9% by 2010. Competition and pressure to grow its retail and private banking base will constraint AUB's ability to hit its stated target of 50% non-interest income as a proportion of total income.

Non-interest income / total income ratio



Source: BKME, SHUAA Capital

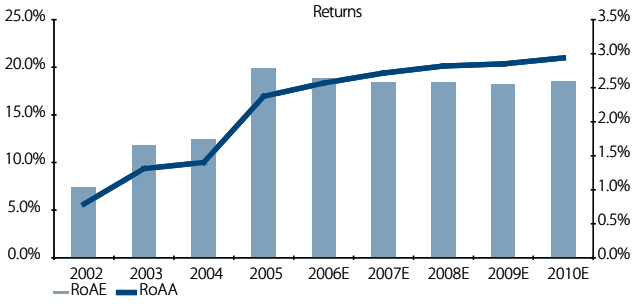
Non performing loans and capital adequacy

Non performing loans (NPLs) as a percent of total loans have been in the range of 3.2% to 3.8% during the last three years. We expect it to rise from 3.58% in 2005 to 3.80% in 2006 as increased stock market volatility push up non performing loans. Beyond 2006 NPLs should drop gradually to reach 3.1% by 2010. AUB's management, which now exercises more control over BKME, is likely to improve risk management. In addition, the positive economic outlook will also help keep NPLs down. Loan loss provision or coverage is expected to improve from 64.2% in 2005 to 90% by 2010. Capital adequacy is also set to increase substantially from an estimated 20.4% in 2005 to 27.4% in 2010. High retained earnings as well as reserves will account for the increase.

Earnings

Profits to grow by 13.2% in 2006

As the above drivers generate growth, RoAE is expected to be lower than the record 2005 levels but higher than pre 2005 levels. However, RoAA should continue to rise as assets are better utilized. Profit growth will be 13.2% in 2006 compared 2005 reaching USD 45.2 mn. BKME should grow profits by a compounded annual growth rate (CAGR) of 13% through the forecast period. Improvements in the bank's efficiency will allow for a drop in the cost to income ratio from 37.4% to 29.8% during the same period. By 2010 the bank should achieve KWD 72.4 mn in profit a RoAE of 18.5% and a RoAA of 2.94%.



Source: BKME, SHUAA Capital

Overview of the Qatari Banking Sector

Banking Sector Environment & Profitability

Banking sector assets grew by 42% in 2005

The banking sector's assets increased to QAR 130.3 bn (USD 35.8 bn) in 2005 from QAR 92 bn in 2004, an increase of 41.6%. Deposit growth actually outpaced loan growth in 2004 and 2005. This resulted in a drop of the loans to deposits ratio to 80%. The sector is expanding due to the oil boom in the region as well as the significant projects underway (especially the gas sector). Public finances are very positive and the real estate and capital markets have been performing well. Qatar now has the highest per capita standard of living in the world. Economy as well as population growth are set to continue at their high pace through 2009. Profitability within the non-Islamic commercial banking sector increased from an aggregate of QAR 1,628 mn at the end 2004 to QAR 3,218 mn in 2005, an increase of 98%. This produces a sector RoAE of 23.3% and a ROAA of 4.0% for 2005. Loans as a ratio of GDP is actually lower than Kuwait and Bahrain, with further room for loan growth as the expatriate population grows and government diversification programs start to show results.

Qatar Banking Sector	2003	2004	2005 E
Bank deposits/GDP	60%	58%	65%
Loans to the private sector/GDP	50%	47%	51%
Assets/GDP	87%	89%	99%
Deposits growth	15%	14%	40%
Loans growth	21%	11%	39%
Loans/deposits	82%	80%	80%

Source:: BMI, EIU, S&P, QCB, SHUAA Capital

Competitive Environment

Four major commercial banks account for 72% of sector's assets

The following tables rank the locally listed commercial banks based on assets. There are four local and commercial banks listed on the Doha Securities Market. Foreign and Islamic banks play an important role by increasing the level of competition. The four banks account for 72% the banking sectors assets and 77% of deposits. The market is still heavily dominated by Qatar National Bank (QNB). QNB holds 56% of deposits and provides 58% of loans.

2005 Rank by assets (QAR 000's)	Total assets	Equity	Customer deposits	Loans
Qatar National Bank	50,060,156	7,930,259	36,706,165	31,477,500
Commercial Bank of Qatar	22,181,543	5,303,345	13,238,178	10,884,138
Doha Bank	15,230,229	2,400,836	11,048,845	8,294,718
Al Ahli Bank Qatar	6,181,033	1,075,158	4,530,465	3,490,141

Source:: company financials

Unlike Kuwait, smaller banks are not disadvantaged by size in Qatar. For example, Commercial Bank of Qatar (QNB) enjoys the highest RoAE and RoAA of the four, though it does not have a significant profitability advantage over its peers. New entrants are expected in the market, both foreign and local, which is likely to force competitive pressure on the smaller banks. The recently public Al Rayan Bank is an example. Al Ahli Bank Qatar entered a management contract with AUB in 2004, and has undergone some restructuring. This has caused it to under perform other banks on a relative scale, especially on a cost-to-income level.

2005 Rank by assets (QAR 000's)	Net profit	Net profit growth	RoAE	RoAA	Cost-to-income	Interest spread
Qatar National Bank	1,536,812	86%	22%	3.4%	29%	2.7%
Doha Bank	749,518	117%	19%	4.3%	26%	2.4%
Commercial Bank of Qatar	789,867	114%	40%	6.0%	22%	3.0%
Al Ahli Bank Qatar	141,621	64%	15%	2.7%	39%	2.1%

Source:: company financials

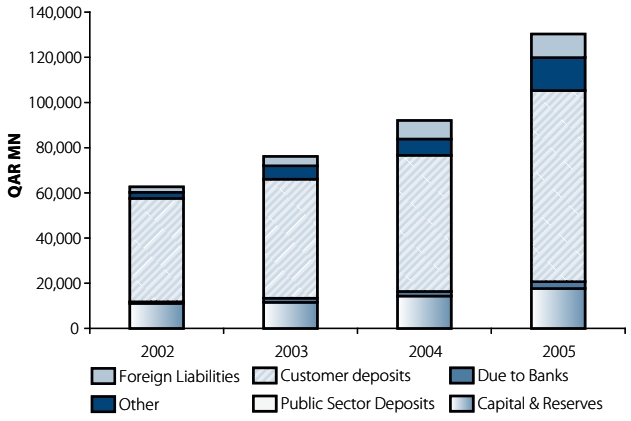
Banking Regulation

The main regulations pertaining to the Qatari banking sector are listed in Appendix III.

Sources of Funds

Banking sector deposits-to-GDP is expected at 65% for 2005, versus 58% in 2004. This improvement in the ratio occurred despite strong economic growth, as deposits grew by 40% during this time. The oil & gas related boom, coupled with a loose monetary policy in the US, are the principal cause for this increase. Capital and reserves dropped as a proportion of total assets, from 17.68% in 2002 to 13.56% in 2005, as banks were significantly over capitalized. These figures are still higher than in Kuwait and Bahrain, with 12.69% and 9.09%, respectively. On the other hand, foreign liabilities increased from 3.81% to 7.99% over the same period of time.

Sources of Funds



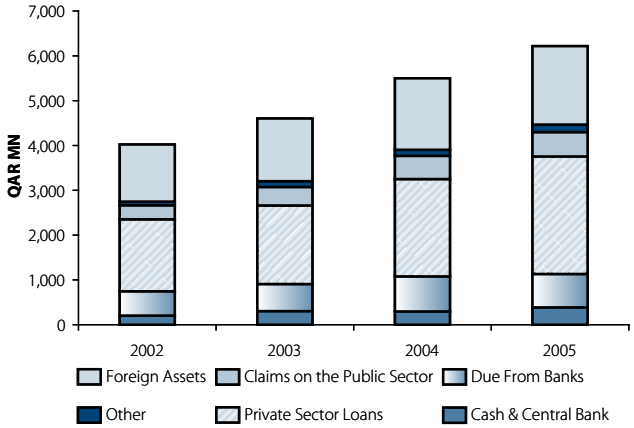
Source: QCB

Uses of Funds

Lending fell relative to total assets

Despite a high loans' CAGR of 29% between 2002 and 2005, the high liquidity and favorable economic conditions suggest that a higher growth rate could have been achieved. However, given the limits on borrowing demand and the still relatively undiversified, government-centric economy, lending actually fell as a total of assets, from 57.41% in 2002 to 51.70% in 2005. This caused foreign assets to increase from 21.87% to 31.96%, as banks looked to fulfill their investments needs abroad.

Uses of Funds

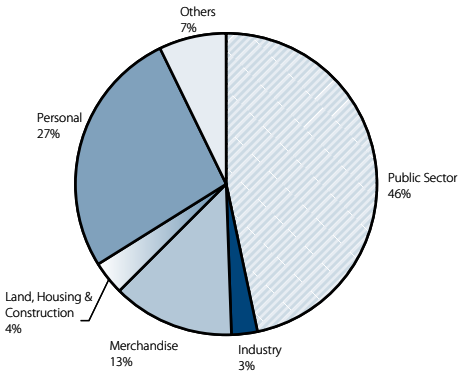


Source: QCB

Public sector accounts for 46% of loans

Loans to the public sector accounted for 46% of total loans in 2005. This is a direct result of the economic characteristic mentioned above. This ratio should decline further as government privatization and economic diversification begin to reshape the economy. QNB is the dominant player in public loans, partly because it is 50% government-owned and enjoys strong ties with public entities. Consequently, the other banks are focusing most of their efforts on the second biggest segment, which is personal loans

Distribution of loans by sector

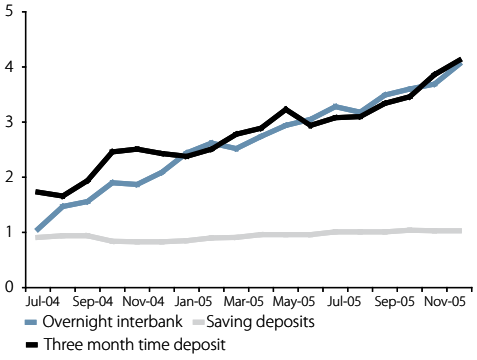


Source: QCB

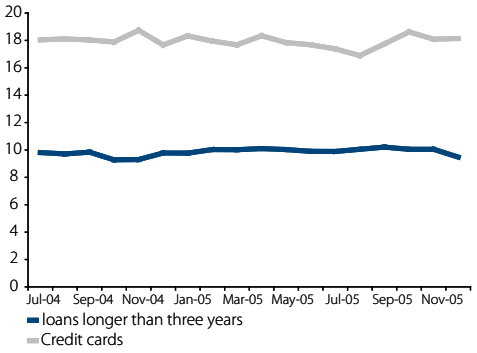
Interest Rates

As is the case with Kuwait and Bahrain, interest rates in Qatar follow the US Federal Reserves. These have been on the rise, as discussed earlier. Short term rates have picked up, however, while rates on saving deposits and long term loans have remained largely flat in 2005. Banks that use deposits as their main interest-bearing liabilities, and that have significant exposure to shorter term assets such as overnight inter bank rates and credit cards, have experienced weaker spreads.

Interest rates on sources of funds (%)



Interest rates on uses of funds (%)



Source: QCB

Quality of Assets & Capital Adequacy

Sufficient capital adequacy but asset quality deteriorated in 2005

The NPLs of listed commercial banks increased by 4.9% in 2005. They amounted to 5.05% of gross loans, compared with 6.4% in 2004, whilst their provision coverage decreased to 61.3% from 73.1%. Although this represents a slight improvement, low coverage remains an issue. We expect NPLs to loans ratio to gradually decrease as the economy continues to expand, which means that bank loans' growth should outpace NPL growth comfortably. Capital adequacy is sufficient to fulfill both central bank and Basel II requirements, with a current estimated capital adequacy of 22.9%.

Investment Banking and Islamic Banking

Investment banking is relatively underdeveloped in Qatar, with low activity and a limited number of funds. However, as in other regional markets, IPOs have been very successful Al Rayan Bank, for example, was oversubscribed numerous times. New government regulations have forced banks to divest their brokerage operations, and hold shares in a single, government-sanctioned broker instead. That broker is Dlala Brokerage and Investment.

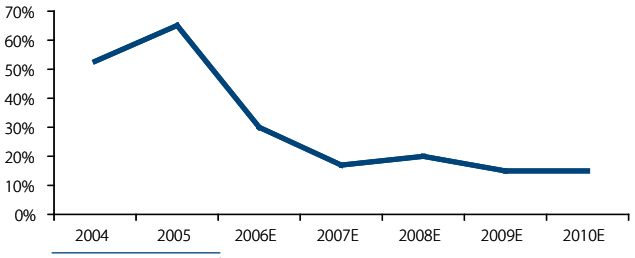
Islamic banks are increasingly popular in Qatar, and they have been quite active. Local commercial banks also provide a number of Islamic banking services. The two main Islamic banks currently operating are Qatar Islamic Bank and Qatar International Islamic Bank. They compete directly with commercial banks over Islamic banking products, and indirectly over general banking services.

Analysis and Forecasts for Ahli Bank Qatar (ABQ)

Sources of funds

Unlike BKME, ABQ has enjoyed significant growth in customer deposits since AUB took over in 2004. In 2005, customer deposit growth reached 65.1% , the need to borrow from banks fell, and management actually lowered its due to banks by 22.6% . This is inline with AUB's focus on the retail business. It is also a good move as interest rates go up, since rates on customer deposits are more stable than due to banks. However, customer deposit growth should slow down through 2006 and 2007. In 2008, when many of Qatar's major projects are expected to be finished, the economy should experience significant growth. Deposit growth should thus increase to 20% in 2008, versus 17% in 2007. Due to banks will continue to decline as a ratio of customer deposits from 20.8% in 2004 and 9.7% in 2005 to 7.7% in 2006 and thereafter.

Customer deposit growth

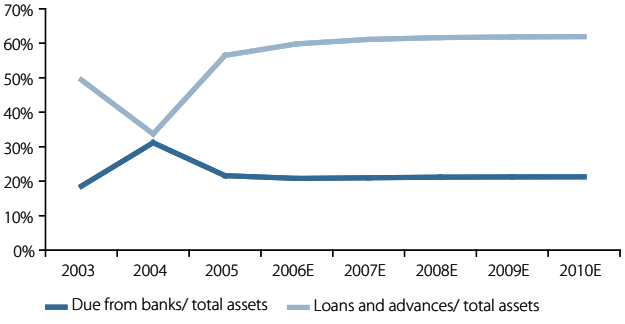


Source: ABQ, SHUAA Capital

Uses of funds

AUB initiated an assets allocation shift between 2004 and 2005 after taking over the bank. It shifted a greater weighting to loans and advances versus due from banks. We expect this allocation to be slightly more emphasized by 2010. Loans should account for 62.9% of total assets by 2010, versus 56.5% in 2005. Loans will only rise relative to deposits from 77% in 2005 to 80% by 2010, well below the central bank limit of 90%. Due from banks should drop to 21.3% of assets, versus 21.6% during the same time period. Note that growth in due from banks will still outpace due to banks. Due from banks as a proportion of due to banks will increase from 159% in 2003 and 303% in 2005, to 355% by 2010. This indicates that the bank will continue to allocate some excess funds to due from banks but will not use due to banks as a major funding source.

Asset Allocation Shift



Source: ABQ, SHUAA Capital

Interest income

Spreads to improve in 2006

While interest spreads are expected to drop by 5 basis points at BKME in 2006, they are expected to increase at ABQ by 10 basis points. The bank's allocation shifts on both the sources and uses of funds should help to raise yields faster than the cost of funds. This is taking place in the backdrop of Qatari economy that is more vibrant and has more potential for growth than Kuwait's, and should provide ABQ with more room to grow loans while raising rates.

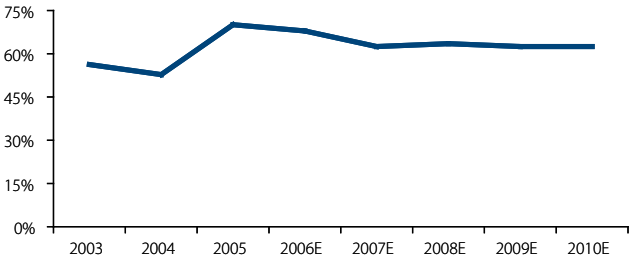
Spreads & margins	2003	2004	2005	2006E	2007E	2008E	2009E	2010E
Average IEAs yield	5.11%	3.33%	5.33%	5.73%	5.73%	5.83%	5.73%	5.73%
Cost of funds	3.86%	1.53%	3.19%	3.49%	3.49%	3.49%	3.49%	3.49%
Spread	1.25%	1.81%	2.14%	2.24%	2.24%	2.34%	2.24%	2.24%
Margin	3.43%	2.07%	2.70%	2.76%	2.71%	2.79%	2.69%	2.69%

Source: ABQ, SHUAA Capital

Non-interest income

Non-interest income peaked in 2005 to 70.1% of total income, after an increase of 165% to QAR 95 mn. Since the increase is partially due to significant IPO activity in Qatar, we do not believe it to be a fully recurring income stream. Therefore, we are lowering the ratio to 67.2% by 2006, and to more normal levels of 62.5% by 2010. The forecasted levels will however remain above those of 2003 and 2004, maintained by fee income from the improved retail business.

Non-interest income / total income ratio



Source: ABQ, SHUAA Capital

Non performing loans and capital adequacy

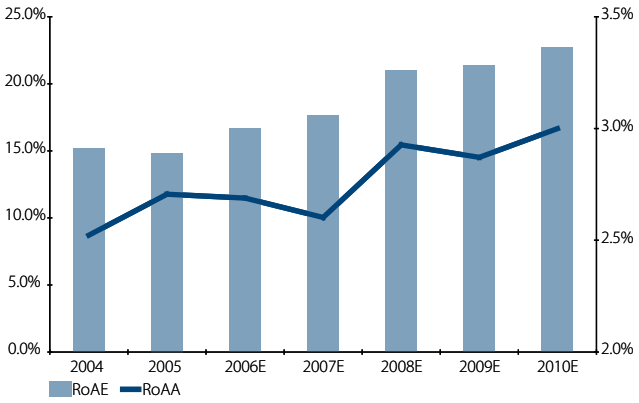
AUB was able to significantly lower ABQ's non performing loans (NPLs) to gross loans after taking over management. NPLs/gross loans fell from 32.8% in 2003 to 9.7% in 2005. We expect this trend to continue as the risk management improves while loans grow. By 2010 the ratio should reach 4.2%. Provision coverage should also improve from 63.8% to 85% as coverage improves throughout the entire sector. NPL coverage is lower in Qatar than in regional peers, and will have to eventually be increased. Since we are expecting strong growth in deposit driven liabilities and assets, capital adequacy should gradually decline from 22.1% in 2005 to 16.5% in 2010.

Earnings

Profits to grow by 33% in 2006 reaching QAR 188 mn

While growth drivers should generate strong growth, non-interest costs expressed through the cost to income ratio will rise from 38.6% in 2005 to 39.8% in 2006, and then drop to 29.3%. The cause is an assumed increase in loan loss provisioning in order to increase coverage of NPLs. Beyond 2006, the cost to income ratio will drop due to management improvements and increased economies of scale. In 2006 profit growth is expected at 33% in 2006 to QAR 188 mn. RoAE is expected to be higher than the 2005 levels, increasing from 14.8% to 16.7%. ABQ should grow profits by CAGR of 23% throughout our forecast period. By 2010 the bank should achieve QAR 397 mn in profit, a RoAE of 22.7% and a RoAA of 3.00%.

Returns

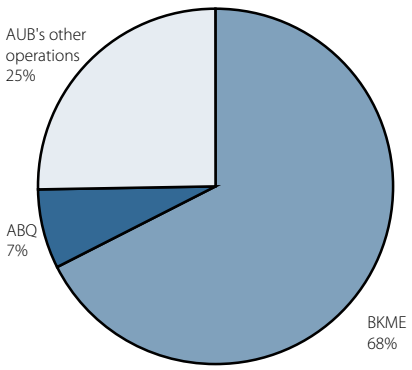


Source: ABQ, SHUAA Capital

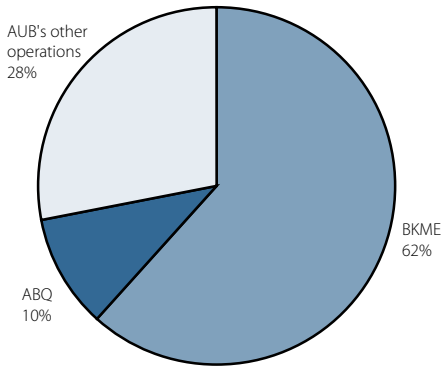
AUB consolidated big picture

Overall AUB is set for strong growth in profits and an improvement in return. On consolidated basis, its net profits are projected to grow at a CAGR of 28% through our projected period. RoAE and RoAA are set to reach21.8% and 2.38%, respectively by 2010, markedly higher than current levels. For 2006 we are expecting profit of USD 276 mn, an increase of 67% over 2005. The acquisition of a majority holding in BKME during 2005, resulted in a significant improvement in AUB's consolidated RoAE from 13.9% in 2005 to 17.9% in Q1 2006. RoAE is expected to reach 19.3% in 2006. Higher RoAE is partly due to the use of non-equity based funding to finance the acquisiton. The main issue that remains, which is not discussed in this report but can have a huge impact on AUB's value, is possible acquisitions and or expansions into new markets.

Adjusted profit contribution 2005



Adjusted profit contribution 2010



AUB Valuation

We initiate coverage on AUB with a Buy recommendation…

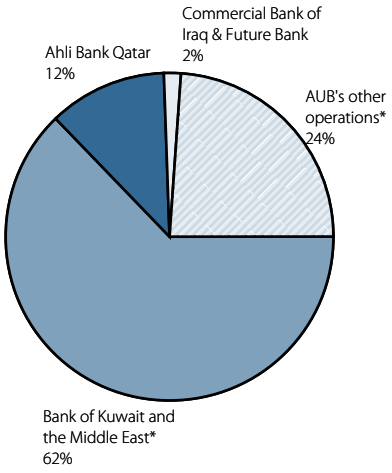
… and a target price of USD 1.30 per share

We used two valuation methods to estimate a market value for AUB's equity; a discounted equity cash flow and a relative valuation. Our analysis yielded a value of USD 3,543 mn or USD 1.30 per share. The result indicates an upside of 51%, hence our buy recommendation. We gave the DECF a weight of 70% and our multiple a weight of 30% as per our standards.

Discounted Equity Cash Flow (DECF) Valuation

The DECF for AUB resulted in a value of USD 3,373 mn or USD 1.24 per share. This was derived from a sum of parts valuation. We valued AUB's consolidated operations (AUB Bahrain, AUB UK, and BKME) separately from the bank's associates: Ahli Bank Qatar (ABQ), Future Bank and Commercial Bank of Iraq. Discussion of ABQ's valuation is included under ABQ's respective section. AUB's smaller holdings in Future Bank and Commercial Bank of Iraq were valued at their book value.

Value Contribution



** Value implied through BKME Valuation*

AUB DECF excluding associates

The valuation of AUB excluding associates was based on a five year cash flow forecast and a fading period of 15 years during which the long run RoAE gradually approaches the bank's cost of equity. Free cash flows were calculated by adjusting projected net income by the central bank's 12% minimum capital adequacy requirement. The weighted average cost of equity used until 2008 was 8.54%. This was based on a cost of equity of 8.55% and a cost of preferred shares of 8.30%. Beyond 2008, the cost of equity was used as the preferred shares became redeemable. We used a risk-free rate of 5.45%, an equity risk premium of 5.00%, and an industry beta of 0.68. Finally we deducted USD 150 mn in preferred share value from the outcome.

Relative valuation

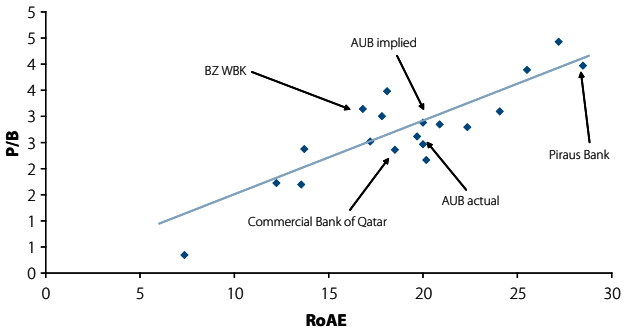
Our second valuation is based on a regression of the price to book multiple of a peer group against 2006 RoAE. The peer group includes the following emerging market banks (refer to appendix IV):

Bz WBK	Fortis Bank AS	Wing Lung Bank
Kredyt Bank	Piraeus Bank	Commercail Bank of Qatar
Finans Bank	Banco Pastor	Al Ahli bank of Kuwait
Deniz Bank	Wing Hang Bank	Burgan Bank
Banco De Chile	Bank Inter	Bank of Bahrain and Kuwait
Banco Credit	Dah Sing Banking	

Price to book ratio = 15.37 (return on equity) R^2= 0.75
Implied price to book ratio for AUB = 2.88

The relative valuation of AUB resulted in a value USD 3,940 mn or USD 1.44 per share.

Price to book regression



AUB Consolidated Balance Sheet - (USD '000)

Year at December	2004	2005	2006E	2007E	2008E	2009E	2010E
Cash and due from central bank	60,653	140,575	469,115	313,113	351,225	384,266	478,250
Government securities		982,850	1,114,439	1,199,252	1,295,235	1,398,946	1,510,960
Government debt bonds		318,712	345,377	376,461	410,343	447,274	487,528
Investment securities	1,922,587	2,268,593	2,483,743	2,655,682	2,846,628	3,028,329	3,221,804
Due from banks	2,173,056	3,028,965	3,263,169	3,502,483	3,757,440	4,004,019	4,267,083
Loans and advances (net of provisions)	2,901,842	5,986,396	6,830,454	7,283,512	7,825,586	8,364,734	8,941,799
Fixed assets	58,150	127,312	133,553	138,169	142,314	146,583	150,981
Investment in associates	820,170	351,012	430,836	523,802	646,773	787,497	956,178
Goodwill	28,032	393,364	393,364	393,364	393,364	393,364	393,364
Other assets	160,382	274,450	312,089	292,335	270,555	243,338	211,932
Total assets	**8,124,872**	**13,872,229**	**15,776,140**	**16,678,172**	**17,939,462**	**19,198,349**	**20,619,880**
Customer deposits	4,009,084	6,663,104	7,559,132	8,163,863	8,775,266	9,388,037	10,044,474
Due to banks	1,829,793	3,797,163	4,268,606	4,506,717	4,836,962	5,159,094	5,503,107
Certificates of Deposit	116,724	43,034	43,034	43,034	43,034	43,034	43,034
Term Debt	946,427	1,405,940	1,541,403	1,375,335	1,426,983	1,465,299	1,553,217
Other liabilities	155,141	269,765	373,822	400,120	429,423	457,984	488,484
Total liabilities	**7,057,169**	**12,179,006**	**13,785,998**	**14,489,068**	**15,511,667**	**16,513,447**	**17,632,315**
Minority Interest		255,580	346,638	369,377	398,928	430,842	465,309
Total shareholders' equity	**1,000,903**	**1,367,618**	**1,497,240**	**1,658,484**	**1,843,675**	**2,048,868**	**2,285,562**
Dividends payable	66,800	70,025	146,264	161,243	185,192	205,192	236,694
Total liabilities and equity	**8,124,872**	**13,872,229**	**15,776,140**	**16,678,172**	**17,939,462**	**19,198,349**	**20,619,880**

Source: AUB, SHUAA Capital

AUB Consolidated Income statment - (USD '000)

Year to December	2004	2005	2006E	2007E	2008E	2009E	2010E
Interest income	254,018	479,787	716,989	782,906	839,553	899,751	961,882
Interest expense	-129,166	-305,224	-453,596	-492,705	-522,778	-557,656	-594,148
Net interest income	**124,852**	**174,563**	**263,393**	**290,201**	**316,775**	**342,095**	**367,734**
Net fee and commission income	40,202	75,600	113,072	119,494	130,563	146,345	168,037
Trading and investment income	28,779	41,122	81,206	76,945	80,771	84,060	65,902
Income from associates	41,748	60,236	79,824	92,966	122,971	140,724	168,681
Other income	7,448	7,337	9,360	9,893	10,314	10,684	11,085
Total non-interest income	118,177	184,295	283,462	299,297	344,619	381,813	445,258
Total income from operations	**243,029**	**358,858**	**546,855**	**589,498**	**661,394**	**723,908**	**812,992**
Staff expenses	-47,605	-71,111	-102,465	-111,336	-119,261	-126,417	-134,002
Total provision charge	-41,114	-31,438	-41,428	-18,819	-24,112	-27,070	-29,050
Depreciation	-7,240	-9,307	-13,768	-14,337	-14,797	-15,241	-15,698
Other expenses	-45,354	-51,496	-64,949	-65,789	-69,632	-75,254	-82,851
Total non-interest expenses	-141,313	-163,352	-222,611	-210,281	-227,802	-243,982	-261,601
Profit before tax	**101,716**	**195,506**	**324,244**	**379,217**	**433,592**	**479,926**	**551,390**
Taxes	4,829	-5,730	-9,675	-11,397	-13,011	-14,422	-16,277
Minority Interest		-24,911	-38,683	-45,333	-50,198	-55,120	-61,724
Net profit	**106,545**	**164,865**	**275,886**	**322,486**	**370,384**	**410,384**	**473,389**

Source: AUB, SHUAA Capital

AUB Consolidated - Key ratios (%, unless otherwise stated)

Year to December	2004	2005	2006E	2007E	2008E	2009E	2010E	CAGR
Growth								
Equity	6.9	36.6	9.5	10.8	11.2	11.1	11.6	14.8
Assets	29.6	70.7	13.7	5.7	7.6	7.0	7.4	16.8
Loans	15.8	106.3	14.1	6.6	7.4	6.9	6.9	20.6
Deposits	42.8	66.2	13.4	8.0	7.5	7.0	7.0	16.5
Net interest income	11.5	39.8	50.9	10.2	9.2	8.0	7.5	19.7
Operating income	24.4	47.7	52.4	7.8	12.2	9.5	12.3	22.3
Net profit	22.4	54.7	67.3	16.9	14.9	10.8	15.4	28.2
Capital adequacy								
Equity / Assets	12.3	9.9	9.5	9.9	10.3	10.7	11.1	
Equity / RWA	18.9	14.9	14.5	15.0	15.6	16.2	17.0	
Asset quality								
NPLs / Loans	7.5	2.0	2.2	2.1	2.1	2.0	2.1	
Loan loss provision / NPLs	77.4	95.5	101.6	108.6	114.2	123.4	127.3	
Margins & profitability								
Net interest spread	1.9	1.7	1.8	1.8	1.8	1.8	1.8	
Net interest margin	2.0	1.8	2.0	2.0	2.0	2.0	2.1	
Profit margin	28.6	24.8	27.6	29.8	31.3	32.0	33.6	
RoAE	11.0	13.9	19.3	20.4	21.2	21.1	21.8	
RoAA	1.5	1.5	1.9	2.0	2.1	2.2	2.4	
Efficiency								
Cost to income	58.1	45.5	40.7	35.7	34.4	33.7	32.2	
Non-interest inc. to total revenues	48.6	51.4	51.8	50.8	52.1	52.7	54.8	
Liquidity								
Loans to deposits	72.4	89.8	90.4	89.2	89.2	89.1	89.0	
Loans to IEAs	41.5	47.6	48.7	48.5	48.5	48.5	48.5	

Source: AUB, SHUAA Capital

SHUAACAPITAL PSC

Bank of Kuwait and the Middle East (BKME.KW)

Equity Research — Initial Coverage

April 26th, 2006

Current Price:	KWD 0.73	**Country:**	Kuwait
Fair value Target:	KWD 0.93	**Sector:**	Commercial Banking
Recommendation:	BUY	**Exchange:**	Kuwait Stock Exchange

Sector Coverage Team

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- Bank of Kuwait and the Middle East (BKME) is the smallest local commercial bank in Kuwait in terms of assets and profits. Its current market capitalization is KWD 616.7 mn (USD 2,111 mn). AUB, being a majority shareholder in the bank with a 75% stake, exerts significant influence over BKME's strategy.

- In addition to its focus on retail banking, BKME holds 50.1% of Kuwait & Middle East Financial Investment Company (KMEFIC), a brokerage and asset management firm with primary exposure to the Kuwaiti market. The bank's ability to grow profits will be somewhat limited by pressure on spreads due to competition from the bigger banks. Nevertheless, the bank is expected to grow profits by reducing its cost to income ratio and increasing its non-interest income beyond 2006.

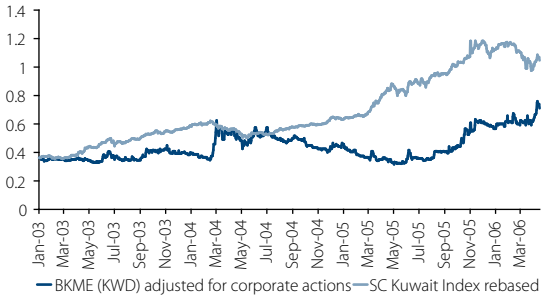
- We initiate coverage on BKME with a Buy recommendation since our target value of KWD 0.93 per share is 27% above the recent price of KWD 0.73 per share.

Year	Net profit (KWD'000)	BV (KWD'000)	EPS (KWD)	BVPS (KWD)	RoAE (%)	P/E (x)	P/BV (x)
Dec-08E	58,641	335,108	0.07	0.40	18.4	10.5	1.8
Dec-07E	52,958	302,855	0.06	0.36	18.4	11.6	2.0
Dec-06E	45,189	273,728	0.05	0.32	18.9	13.6	2.3
Dec-05	39,919	204,917	0.05	0.24	19.9	15.4	3.0

52-week range (KWD)	0.76-0.32
Number of shares (000')	844,727
Free Float (%)	15
Market cap (KWD'000)	616,651
Market cap (USD'000)	2,110,733
Div. Yld. 2005 (%)	4.1%

Source: Reuters, SHUAA Capital

BKME stock performance vs. SC Kuwait Index



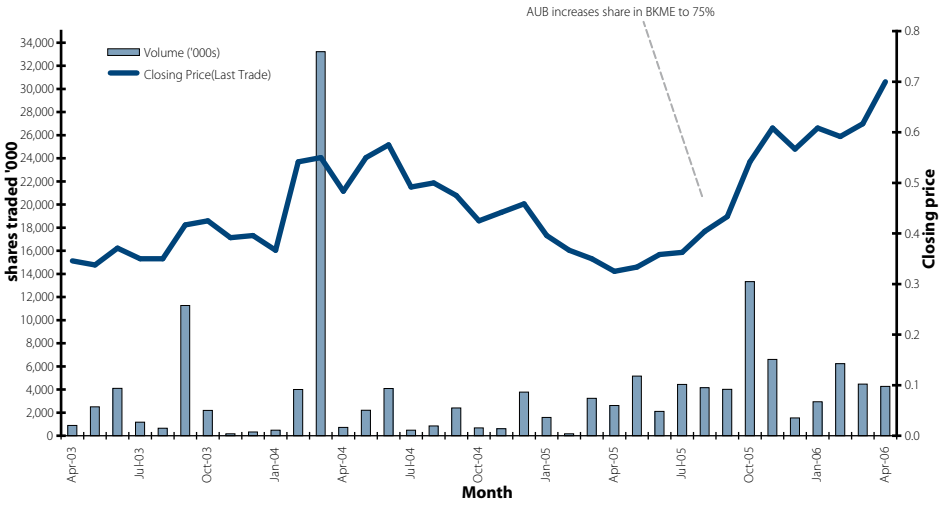
Investment Highlights

- BKME is 75% owned by AUB, which exerts significant influence on the bank's operations. The bank's focus is on retail and private banking. Although BKME is the smallest of the six commercial banks in Kuwait, it has the fourth largest branch network. It also has strong exposure to the Kuwaiti capital market through its 50% holding in Kuwait & Middle East Investment Company (KMEFIC). KMEFIC operates an asset management and brokerage division.

- BKME hopes to increase its market share significantly by 2008 from its current 10% of total assets. Achieving this goal may prove difficult due to the dominance of the bigger banks, especially NBK.

- The bank's long-term default rating by Fitch is BBB+ with a stable outlook. KMEFIC's performance is highly related to stock market activity and could be impacted by the current market downturn. Because BKME is also the smallest of the six local commercial banks it will have to compete more aggressively on rates, putting pressure on its spreads.

- We used two valuation methods to estimate a market value for BKME. We used a discounted equity cash flow and a relative valuation. Our analysis yielded a value of KWD 781.5 mn or KWD 0.93 per share. The DECF for BKME resulted in a valuation of KWD 854 mn, or USD 1.01 per share. Our second valuation is based on a regression of the price to book multiple of a peer group against forward RoAE. The relative valuation of BKME resulted in a value KWD 612.4 mn, or KWD 0.72 per share.



Valuation

We initiate coverage on BKME with a Buy recommendation…

… and a target price of KWD 0.93 per share

We used two valuation methods to arrive at fair value for BKME. We used a discounted equity cash flow (DECF) and a relative valuation. Our analysis yielded a valuation of KWD 781.5 mn, or KWD 0.93 per share. Relative to the current price the value indicates a 27% upside potential, hence our buy recommendation. We gave the DECF a weight of 70% and our multiple a weight of 30%, as per our standards.

Discounted Equity Cash Flow (DECF) Valuation

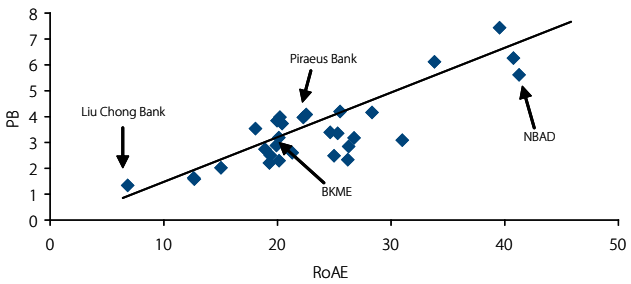
The DECF for BKME resulted in a value of KWD 854 mn, or KWD 1.01 per share. It was based on a five year cash flow forecast and a fading period of 15 years during which the long run RoAE gradually approaches BKME's cost of equity. Free cash flows were calculated by adjusting projected net income to the central bank's 12% minimum capital adequacy requirement. The cost of equity used was 8.85% and is based on a risk-free rate of 5.45%, an equity risk premium of 5.00%, and an industry beta of 0.68.

Relative valuation

Our second valuation is based on a regression of the price to book multiple of a peer group against trailing RoAE. Based on the regression equation below, the relative valuation of BKME resulted in a value KWD 612.4 mn, or KWD 0.72 per share. Check appendix IV for a list of comparables.

Price to book ratio = 15.01 (return on equity) R^2=0.70
Implied price to book ratio for BKME = 2.99

Price to book regression



BKME Balance Sheet - (KWD '000)

Year at December	2004	2005	2006E	2007E	2008E	2009E	2010E
Cash and due from central bank	170,561	92,179	147,478	105,011	126,028	149,247	176,465
Treasury Bills	256,633	279,304	326,654	351,503	379,623	409,993	442,793
Government Debt Bonds	127,124	93,067	100,867	109,946	119,841	130,626	142,383
Investment securities	111,100	119,623	137,002	147,424	159,218	171,956	185,712
Due from banks	233,880	224,826	259,163	285,727	308,586	333,272	359,934
Loans and advances (net of provisions)	822,348	757,827	885,474	941,221	1,016,519	1,097,840	1,185,668
Fixed assets	6,345	16,777	17,784	18,495	19,050	19,621	20,210
Other assets	26,340	28,369	33,147	35,234	38,053	41,097	44,385
Total assets	**1,754,331**	**1,611,972**	**1,907,570**	**1,994,561**	**2,166,917**	**2,353,654**	**2,557,550**
Customer deposits	955,044	938,997	1,079,847	1,166,234	1,259,533	1,360,296	1,469,119
Due to banks	371,315	357,440	404,942	431,507	466,027	503,309	543,574
Certificates of Deposit	135,000	0	0	0	0	0	0
Term Debt	58,940	58,400	66,975	0	0	0	0
Other liabilities	21,736	30,679	35,136	37,809	40,834	44,101	47,629
Total liabilities	**1,542,035**	**1,385,516**	**1,586,901**	**1,635,550**	**1,766,394**	**1,907,706**	**2,060,322**
Minority Interest	16,254	21,539	26,606	32,325	39,027	46,449	54,598
Total shareholders' equity	**196,042**	**204,917**	**273,728**	**302,855**	**335,108**	**370,523**	**410,181**
Proposed dividends	0	0	20,335	23,831	26,388	28,976	32,448
Total liabilities and equity	**1,754,331**	**1,611,972**	**1,907,570**	**1,994,561**	**2,166,917**	**2,353,654**	**2,557,550**

Source: BKME, SHUAA Capital

BKME Income statment - (KWD '000)

Year to December	2004	2005	2006E	2007E	2008E	2009E	2010E
Interest income	58,064	77,823	89,052	99,155	106,836	115,447	124,753
Interest expense	-30,476	-39,888	-47,591	-51,568	-54,414	-58,767	-63,468
Net interest income	**27,588**	**37,935**	**41,461**	**47,586**	**52,422**	**56,680**	**61,285**
Net fee and commission income	11,442	18,342	19,901	21,890	24,900	28,907	34,319
Trading and investment income	1,650	11,663	11,624	10,469	11,533	12,470	13,483
FX gains	1,805	2,029	2,218	2,545	2,804	3,032	3,278
Dividend income	2,677	3,669	4,010	4,610	5,078	5,491	5,937
Other income	7,046	964	1,054	1,209	1,332	1,440	1,557
Total non-interest income	**24,620**	**36,667**	**38,806**	**40,723**	**45,648**	**51,339**	**58,574**
Total income from operations	52,208	74,602	80,268	88,309	98,070	108,020	119,859
Staff & general expenses	-10,161	-12,519	-13,395	-14,333	-15,193	-16,105	-17,071
Total provision charge	-6,716	-6,151	-4,703	-2,320	-3,598	-4,748	-5,136
Depreciation	-1,806	-1,569	-1,728	-1,814	-1,877	-1,934	-1,992
Other expenses	-4,890	-7,675	-7,744	-8,086	-9,018	-10,145	-11,574
Total non-interest expenses	-23,573	-27,914	-27,571	-26,553	-29,687	-32,930	-35,773
Profit before tax	**28,635**	**46,688**	**52,697**	**61,756**	**68,383**	**75,089**	**84,086**
Taxes	-996	-1,702	-1,788	-2,096	-2,321	-2,548	-2,854
Minority Interest	-4,863	-5,067	-5,719	-6,702	-7,422	-8,149	-9,126
Net profit	**22,776**	**39,919**	**45,189**	**52,958**	**58,641**	**64,391**	**72,106**

Source: BKME, SHUAA Capital

BKME - Key ratios (%, unless otherwise stated)

Year to December	2004	2005	2006E	2007E	2008E	2009E	2010E	CAGR
Growth								
Equity	14.7	4.5	33.6	10.6	10.6	10.6	10.7	14.9
Assets	17.3	-8.1	18.3	4.6	8.6	8.6	8.7	9.7
Loans	10.2	-7.8	16.8	6.3	8.0	8.0	8.0	9.4
Deposits	8.1	-1.7	15.0	8.0	8.0	8.0	8.0	9.4
Net interest income	27.7	37.5	9.3	14.8	10.2	8.1	8.1	10.1
Operating income	23.5	42.9	7.6	10.0	11.1	10.1	11.0	9.9
Net profit	19.4	75.3	13.2	17.2	10.7	9.8	12.0	12.6
Capital adequacy								
Equity / Assets	11.2	12.7	14.3	15.2	15.5	15.7	16.0	
Equity / RWA	18.4	20.4	23.4	24.3	24.8	25.4	26.1	
Asset quality								
NPLs / Loans	3.2	3.6	3.6	3.4	3.3	3.1	3.1	
Loan loss provision / NPLs	47.4	64.2	65.0	70.0	75.0	85.0	90.0	
Margins & profitability								
Net interest spread	2.0	2.4	2.3	2.3	2.3	2.3	2.3	
Net interest margin	2.0	2.5	2.6	2.7	2.7	2.7	2.7	
Profit margin	27.5	34.9	35.3	37.9	38.5	38.6	39.3	
RoAE	12.4	19.9	18.9	18.4	18.4	18.3	18.5	
RoAA	1.4	2.4	2.6	2.7	2.8	2.8	2.9	
Efficiency								
Cost to income	45.2	37.4	34.3	30.1	30.3	30.5	29.8	
Non-interest inc. to total revenues	47.2	49.2	48.3	46.1	46.5	47.5	48.9	
Liquidity								
Loans to deposits	86.1	80.7	82.0	80.7	80.7	80.7	80.7	
Loans to IEAs	53.0	51.4	51.8	51.3	51.2	51.2	51.2	

Source: BKME, SHUAA Capital

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SHUAACAPITAL PSC

Ahli Bank Qatar (AABQ.QA)

Equity Research — Initial Coverage

April 26th, 2006

Current Price:	QAR 88.80	**Country:**	Qatar
Fair value Target:	QAR 85.50	**Sector:**	Commercial Banking
Recommendation:	NEUTRAL	**Exchange:**	Doha Securities Market

Sector Coverage Team

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- Ahli Bank Qatar (ABQ) is the smallest local commercial bank in Qatar in terms of assets and profits. Its current market capitalization is QAR 3,608 mn (USD 991 mn). AUB is a major shareholder in the bank with a 40% stake. It exerts significant influence on ABQ's strategy through a management contract.

- We expect significant growth in the Qatari banking sector as the Qatari economy continues to outperform regional peers. ABQ's management was taken over by AUB in 2004. Since then there has been substantial restructuring that included a significant drop in non performing loans as a proportion of total loans. We predict strong profit growth throughout our forecast period.

- We initiate coverage on ABQ with a Neutral recommendation since our target value of QAR 85.50 per share is 3.7% below the recent price of QAR 88.80 per share.

Year	Net profit (QAR'000)	BV (QAR'000)	EPS (QAR)	BVPS (QAR)	RoAE (%)	P/E (x)	P/BV (x)
Dec-08E	289,118	1,457,608	7.12	35.88	21.0	12.5	2.5
Dec-07E	218,572	1,298,594	5.38	31.97	17.6	16.5	2.8
Dec-06E	187,675	1,178,379	4.62	29.01	16.7	19.2	3.1
Dec-05	141,621	1,075,158	3.49	26.47	14.8	25.5	3.4

52-week range (QAR)	77.50-102.00
Number of shares (000')	40,625
Free Float (%)	60
Market cap (QAR'000)	3,607,500
Market cap (USD'000)	991,153
Div. Yld. 2005 (%)	-

Source: Reuters, SHUAA Capital

ABQ stock performance vs. SC Qatar Index



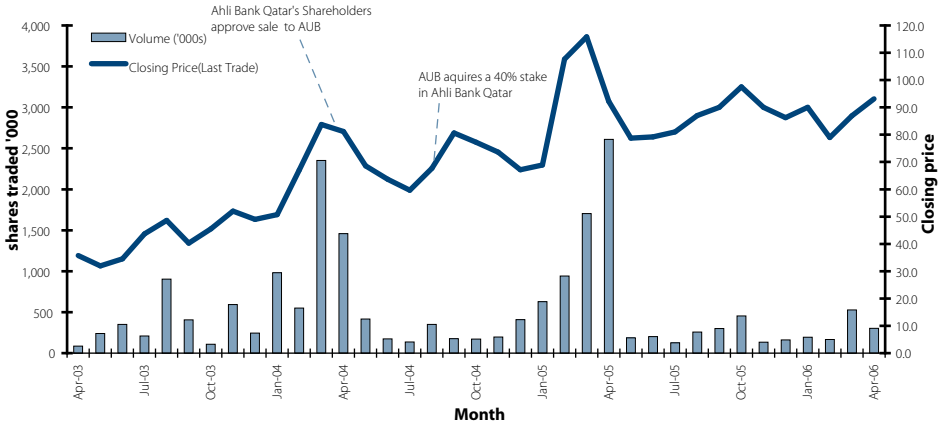
Investment Highlights

- ABQ is 40% owned by AUB, which exerts significant influence on the bank's operations through a ten year management contract obtained in 2004. The bank has just gone through significant restructuring and is currently the smallest of the four local commercial banks.

- ABQ operates seven branches with a focus on expanding the retail business. This is inline with AUB's overall strategic focus on retail and private banking. Management hopes to grow market share beyond the current le vel. We foresee a faster deposit growth than that of the sector average during our forecast period.

- The bank is exposed to general banking risks. Since ABQ is the smallest of the four commercial banks it will have to compete more aggressively on rates placing pressure on its spreads.

- We used two valuation methods to estimate a market value for ABQ; a discounted equity cash flow and a relative valuation. Our analysis yielded a value of QAR 3,474 mn, or QAR 85.50 per share. The DECF for ABQ resulted in a valuation of QAR 3,780 mn, or QAR 93.00 per share. Our second valuation is based on a regression of the price to book multiple of a peer group against forward RoAE. The relative valuation of ABQ resulted in a value QAR 2,759 mn, or QAR 67.90 per share.



Valuation

We initiate coverage on ABQ with a Neutral recommendation…

… and a target price of QAR 85.50 per share

We used two valuation methods to arrive at fair value for ABQ. We used a discounted equity cash flow (DECF) and a relative valuation. Our analysis yielded a valuation of QAR 3,474 mn or QAR 85.50 per share. Relative to the current price of QAR 88.80 per share, the value indicates an 3.7% downside potential, hence our hold recommendation. We gave the DECF a weight of 70% and our multiple a weight of 30%, as per our standards.

Discounted Equity Cash Flow (DECF) Valuation

The DECF for ABQ resulted in a value of QAR 3,780 mn, or QAR 93.00 per share. It was based on a five year cash flow forecast and a fading period of 15 years during which the long run RoAE gradually approaches ABQ's cost of equity. Free cash flows were calculated by adjusting projected net income to the central bank's 12% minimum capital adequacy requirement. The cost of equity used was 8.85% and is based on a risk-free rate of 5.45%, an equity risk premium of 5.00%, and an industry beta of 0.68.

Relative valuation

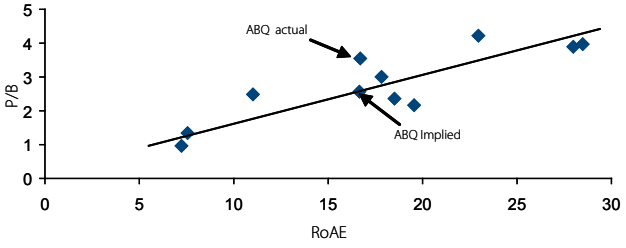
Our second valuation is based on a regression of the price to book multiple of a peer group against 2006 RoAE. The peer group includes the following emerging market banks:

Bank of Bahrain and Kuwait	Piraeus Bank
Qatar National Bank	Liu Chong Bank
Al Ahli bank of Kuwait	Fubon Bank
Burgan Bank	Bank Millennium
Commercial International Bank	

Price to book ratio = 0.2928 + 13.649 (Return on equity) R^2=0.83
Implied price to book ratio for ABQ = 2.57

The relative valuation of ABQ resulted in a value QAR 2,759 mn, or QAR 67.90 per share. The value is substantially lower than our DECF since the estimated RoAE for 2006 is only 16.7% while our DECF analysis assumes a RoAE of 22.7% by 2010. In other words, the multiple valuation does not take into account the strong growth we are anticipating beyond 2006.

Price to book regression



ABQ Balance Sheet - (QAR '000)

Year at December	2004	2005	2006E	2007E	2008E	2009E	2010E
Cash and due from central bank	103,915	147,095	160,296	267,246	242,421	252,772	282,079
Investment securities	1,357,301	1,086,644	1,196,526	1,177,207	1,412,648	1,624,546	1,868,228
Due from banks	1,335,124	1,335,735	1,618,663	1,893,836	2,272,603	2,613,494	3,005,518
Loans and advances (net of provisions)	1,444,843	3,490,141	4,654,975	5,515,230	6,618,275	7,611,017	8,752,669
Fixed assets	27,330	75,038	90,046	103,552	113,908	119,603	125,583
Other assets	17,422	46,380	58,995	64,382	77,258	88,847	102,174
Total assets	**4,285,935**	**6,181,033**	**7,779,502**	**9,021,453**	**10,737,114**	**12,310,278**	**14,136,252**
Customer deposits	2,743,780	4,530,465	5,889,605	6,890,837	8,269,005	9,509,355	10,935,759
Due to banks	569,875	441,330	455,937	533,446	640,135	736,156	846,579
Other liabilities	82,132	134,080	171,127	200,219	240,263	276,302	317,748
Total liabilities	**3,395,787**	**5,105,875**	**6,516,669**	**7,624,502**	**9,149,403**	**10,521,813**	**12,100,085**
Total shareholders' equity	**833,019**	**1,075,158**	**1,178,379**	**1,298,594**	**1,457,608**	**1,639,580**	**1,857,702**
Proposed dividends	57,129	0	84,454	98,357	130,103	148,886	178,464
Total liabilities and equity	**4,285,935**	**6,181,033**	**7,779,502**	**9,021,453**	**10,737,114**	**12,310,278**	**14,136,252**

Source: ABQ, SHUAA Capital

ABQ Income statment - (QAR '000)

Year to December	2004	2005	2006E	2007E	2008E	2009E	2010E
Interest income	109,203	267,775	383,345	459,934	550,540	634,557	729,741
Interest expense	-41,248	-132,169	-197,509	-240,310	-285,050	-334,286	-384,429
Net interest income	**67,955**	**135,606**	**185,835**	**219,624**	**265,490**	**300,271**	**345,312**
Net fee and commission income	27,387	71,738	98,310	103,223	127,435	141,128	162,297
Trading and investment income	0	11,102	11,150	14,276	17,257	19,518	22,445
FX gains	5,015	9,554	13,093	15,473	18,705	21,155	24,329
Dividend income	2,001	2,560	3,508	4,146	5,012	5,669	6,519
Other income	1,446	81	111	131	159	179	206
Total non-interest income	**35,849**	**95,035**	**126,172**	**137,250**	**168,568**	**187,649**	**215,796**
Total income from operations	103,804	230,641	312,008	356,873	434,058	487,920	561,108
Staff & general expenses	-47,692	-79,182	-91,059	-98,344	-106,212	-111,522	-117,098
Total provision charge	15,816	5,254	-15,556	-20,186	-16,507	-21,787	-21,507
Depreciation	-6,088	-8,732	-9,905	-11,616	-13,048	-14,011	-14,711
Other expenses	20,324	-6,360	-7,813	-8,156	-9,174	-9,743	-11,205
Total non-interest expenses	-17,640	-89,020	-124,333	-138,302	-144,940	-157,063	-164,521
Profit before tax	**86,164**	**141,621**	**187,675**	**218,572**	**289,118**	**330,857**	**396,587**
Net profit	**86,164**	**141,621**	**187,675**	**218,572**	**289,118**	**330,857**	**396,587**

Source: ABQ, SHUAA Capital

ABQ - Key ratios (%, unless otherwise stated)

Year to December	2004	2005	2006E	2007E	2008E	2009E	2010E	CAGR
Growth								
Equity	174.6	29.1	9.6	10.2	12.2	12.5	13.3	11.6
Assets	68.4	44.2	25.9	16.0	19.0	14.7	14.8	18.0
Loans	10.2	141.6	33.4	18.5	20.0	15.0	15.0	20.2
Deposits	8.1	65.1	30.0	17.0	20.0	15.0	15.0	19.3
Net interest income	-18.1	99.6	37.0	18.2	20.9	13.1	15.0	20.6
Operating income	-20.0	122.2	35.3	14.4	21.6	12.4	15.0	19.5
Net profit	18.7	64.4	32.5	16.5	32.3	14.4	19.9	22.9
Capital adequacy								
Equity / Assets	19.4	17.4	15.1	14.4	13.6	13.3	13.1	
Equity / RWA	27.1	22.1	19.0	18.3	17.1	16.8	16.5	
Asset quality								
NPLs / Loans	23.9	9.7	7.8	6.7	5.5	4.8	4.2	
Loan loss provision / NPLs	60.7	63.8	63.8	68.8	73.8	80.0	85.0	
Margins & profitability								
Net interest spread	1.8	2.1	2.2	2.2	2.3	2.2	2.2	
Net interest margin	2.1	2.7	2.8	2.7	2.8	2.7	2.7	
Profit margin	59.4	39.0	36.8	36.6	40.2	40.2	41.9	
RoAE	15.2	14.8	16.7	17.6	21.0	21.4	22.7	
RoAA	2.5	2.7	2.7	2.6	2.9	2.9	3.0	
Efficiency								
Cost to income	17.0	38.6	39.8	38.8	33.4	32.2	29.3	
Non-interest inc. to total revenues	34.5	41.2	40.4	38.5	38.8	38.5	38.5	
Liquidity								
Loans to deposits	52.7	77.0	79.0	80.0	80.0	80.0	80.0	
Loans to IEAs	34.9	59.0	62.3	64.2	64.2	64.2	64.2	

Source: ABQ, SHUAA Capital

Appendix I: Primary banking regulations in Bahrain

Capital requirements
Capital adequacy ratio of 12% and plans to introduce the Basel II reforms with most banks expected to comply with the standardized approach for credit and operational risk. Basel II requirements are expected to be introduced.

Reserve requirements
The central bank requires that 10% of profits are transferred into a legal reserve.

Regulation of foreign and Islamic Banking
Both foreign and Islamic banks are allowed in the market and are regulated by BMA. The Islamic banking sector is huge in Bahrain, and specific BMA regulation exists to promote its success.

Credit Limit
Lending to major shareholders (over 10% ownership) is not allowed
Maximum 15% of regulatory capital base equivalent in exposure to a single client
Personal loans are caped at USD 106,000
Loans to expatriates are limited in that they cannot have an interest greater than 50% of the borrowers salary

Non-performing loans
Loans are considered non-performing once they are 90 days overdue.

Appendix II: Primary banking regulations in Kuwait

Reserve requirements

- 20% of customer deposits (Kuwaiti Dinar) should be maintained with the CBK, in the form of deposits (time and current) or in Treasury Bills and Bonds or in any other financial instrument issued by the CBK.
- Banks are required to transfer 10% of net profit to statutory reserves. This transfer can be discontinued if the statutory reserve exceeds 50% of the paid up capital.
- Net liquid assets must be at least 25% of customer deposits.

Lending limits

- Banks are required to maintain a loans to deposits ratio of less than or equal to 80%. Loans to banks and deposits from banks are not included in this ratio. Banks were required to comply with this regulation by July 2005.
- Maximum credit concentration to a single borrower and his related parties shall not exceed 15% of the capital of the bank.

Capital adequacy

- As per CBK instructions, capital adequacy ratio shall not be less than 12% of risk-weighted assets. As per Basel International Standards (BIS) rules, capital adequacy ratio shall not be less than 8% of risk-weighted assets. The CBK has indicated its intention to follow through Basel II requirements on capital adequacy. We do not anticipate significant impact of this regulation on the overall banking sector as we believe it will be properly capitalized.

Non-performing loans

Loans are considered non-performing once they are 90 days or more overdue.
A 2% provision is required on all loans with no specific provision.

Foreign and Islamic banks

The existing Kuwait Finance House is the second largest bank in Kuwait. The CBK recently allowed the formation of two new Islamic banks, one brand new, and the other a transformation from an existing entity.

The CBK only allowed foreign banks to enter the market in 2005. New entrants include BNP Paribas, HSBC, and National Bank of Abu Dhabi. However they are limited by the number of branches they can operate, and are therefore not likely to focus much of their resources on retail.

Appendix III: Primary banking regulation in Qatar

Reserve requirements

- Banks are required to transfer 20% of net profits to statutory reserves. This transfer can be discontinued if the statutory reserve exceeds 100% of the paid up capital.

Lending limits

- Banks are required to maintain loans to deposits ratio of no less than 90%.
- Maximum credit concentration to a single borrower and his related parties shall not exceed 20% of the capital of the bank. The limit is 10% for a major shareholder.
- Lending for the purchase of securities is limited to 40% of stock value for the Doha Stock Exchange (DSE) and 50% for international markets.
- Real estate lending is limited to 150% of equity or 15% of total deposits, whichever is less.

Capital adequacy

- As per CBQ instructions, the capital adequacy ratio shall not be less than 10% of risk-weighted assets. The CBQ also plans to follow through Basel II requirements on capital adequacy. We do not anticipate significant impact of this regulation on the overall banking sector as we believe banks to be properly capitalized in anticipation. We also do not see significant benefit because most banks will probably use the simplified method of calculating their ratios.

Non-performing loans

Loans are considered non-performing oncethey are 90 days or more overdue, in addition to other smaller requirements.
A 1% provision is required on all loans with no specific provision.

Foreign and Islamic banks

Foreign and Islamic banks are active in Qatar and regulated by the central bank.
Arab Bank and Mashreq Bank, along with international players BNP Paribas, HSBC, and Standard Chartered Bank, are an important part of competition in the sector in both retail and corporate banking. Islamic banks are becoming more popular and they compete with the Sharia compliant products of the commercial banks.

Appendix: IV

Comparable banks	RoAE 2005 (%)	PB (x)
NBAD	41	5.6
NBD	20	3.2
RAK Bank	20	3.7
National Bank of Umm Al Quwain	26	2.3
EBI	26	4.2
ADCB	28	4.2
Mashreq	27	3.2
Commercial Bank of Dubai	23	4.1
UNB	31	3.1
First Gulf	21	2.6
Commercial Bank International	41	6.3
InvestBank	26	2.8
United Arab Bank	20	4.0
Oman Int. Bank	20	2.3
Bank Dhofar	19	2.2
Bank Muscat	19	2.7
NBO	15	2.0
NBK	34	6.1
Gulf Bank	25	3.4
Commercial Bank of Kuwait	25	3.4
Al-Ahli Bank of Kuwait	19	2.5
QNB	20	3.8
Doha Bank	40	7.4
Commercial Bank of Qatar	18	3.5
Bank Millennium	25	2.5
Piraeus Bank	22	4.0
Liu Chong Bank	7	1.3
Corpbanca	13	1.6
Jeonbuk Bank	13	1.6

Comparable banks	RoAE 2006 (%)	PB (x)
Commercial International Bank	28.0	3.89
Bz WBK	16.8	3.14
Kredyt Bank	17.2	2.52
Finans Bank	27.2	4.43
Deniz Bank	25.5	3.89
Banco De Chile	24.1	3.10
Banco Credit	22.4	2.80
Fortis Bank AS	13.7	2.38
Piraeus Bank	28.5	3.97
Banco Pastor	20.9	2.85
Wing Hang Bank	19.7	2.62
Bank Inter	7.4	0.35
Dah Sing Banking	13.5	1.70
Wing Lung Bank	12.2	1.72
Commercail Bank of Qatar	18.1	3.48
Al Ahli bank of Kuwait	17.8	3.00
Burgan Bank	18.5	2.36
Bank of Bahrain and Kuwait	20.2	2.17
Bank Millennium	11.0	2.49
Liu Chong Bank	7.6	1.34
Fubon Bank	7.2	0.96

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