GCC Banking Sector Report

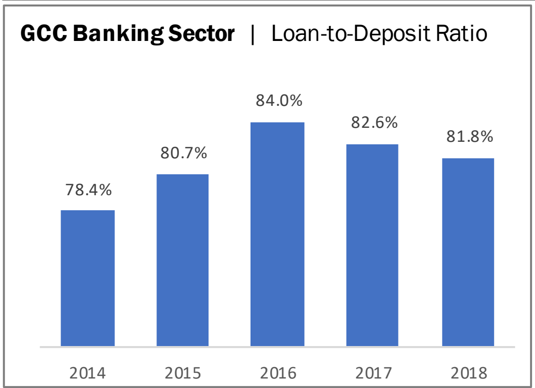
April - 2019

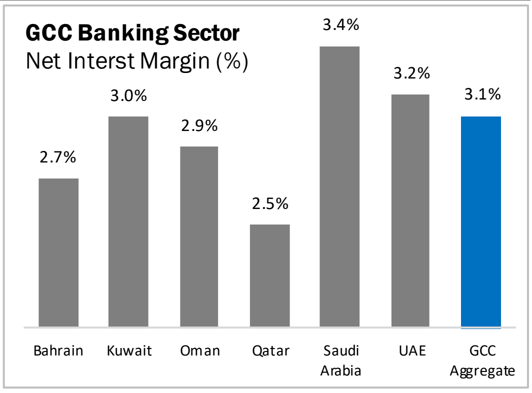
Sound fundamentals continue to support the resilience of GCC Banking sector...

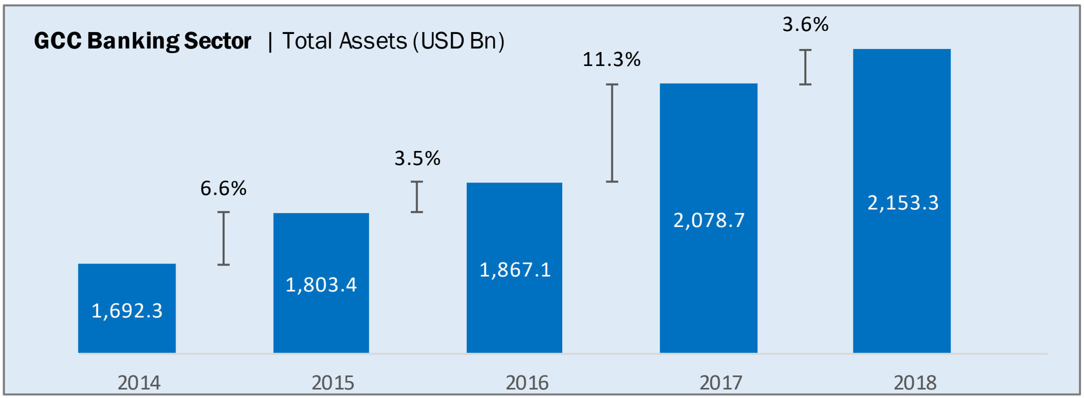
GCC Banking sector continues to boast a strong balance sheet coupled with improving margins as seen from 2018 financial results. The numbers also show minimal impact from the decline in oil prices which continue to remain low as compared to pre-crisis levels. *A number of factors have contributed to the 7% CAGR in total assets of listed banks in the GCC over the past five year. These include a robust project market more than USD 3 Trillion in projects planned or underway, government's focus on developing the non-oil sector, low interest rates with central banks resisting passing on all the rate hikes by the US Fed and lastly the stable economic environment with real growth rates averaging at just over 2% over the past five years.*

In terms of profitability, GCC listed banks have consistently reported higher margins over the past three years. *Net interest margin has grown 10 bps each over the last three years to 3.1% for the aggregate GCC banking sector although loan-to-deposit ratio has declined over the last two years to reach 81.8% one of the lowest globally. Despite a decline in the loan-to-deposit ratio, net income grew by 13.2% during 2018 to reach USD 37 Bn. Higher bottom-line came as a result of 7.7% growth in net interest income while non-interest income grew by 2.4%. Operating expenses as a percentage of total bank revenue also declined by almost 70 bps during 2018, providing additional support to the bottom-line.*

In terms of individual countries, UAE banks reported the largest share of total assets in the GCC at USD 674 Bn or 31% of the sector closely followed by Saudi Arabia at 28%. *In terms of share in net interest income, Saudi Arabia topped with a third of the total followed by UAE at 29.5%. The Kingdom also boasted the highest NIM at 3.4% followed by UAE and Kuwait at 3.2% and 3.0%, respectively. In terms of Customer Deposits, UAE recorded the biggest growth in 2018 at USD 31 Bn or 7% followed by Saudi Arabia at USD 11 Bn. Nevertheless, the growth in the sector came at the cost of higher bad loans. The Non Performing Loan (NPL) ratio saw a steep jump during 2018 to reach 8.0% for the GCC (NPL includes bad loans and loans that are 90-day past due). The increase came primarily on the back of IFRS 9 implementation that did not reflect on NPL numbers for 2017. The sector has also recently seen a number of consolidations creating larger and more efficient banks. The trend is expected to continue in the future given the excess capacity with the regional banks with further scope of cost optimization using innovative services related to banking services.*







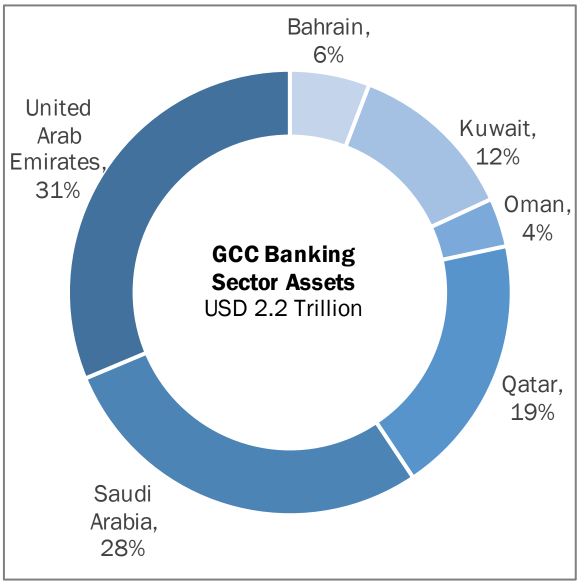
Source : Reuters, Company Financials, KAMCO Research

Faisal Hasan, CFA
Head - Investment Research
+(965) 2233 6907
faisal.hasan@kamconline.com

Junaid Ansari
Vice President
+(965) 2233 6912
junaid.ansari@kamconline.com

Highlights - GCC Banking Sector

This report analyzes financials reported by 66 listed banks in the GCC for 2018. The individual banking data has been aggregated to the country level as there are minimal difference in the countries' regulatory and supervisory environment. We believe that the charts and tables adequately capture the nature and structure of the individual countries' financial systems, their supervision and their monetary operations. Some of the key observations from the most recent financial for the GCC Banking Sector includes the following:



Source : Reuters, Company Financials, KAMCO Research

Strong Balance Sheet

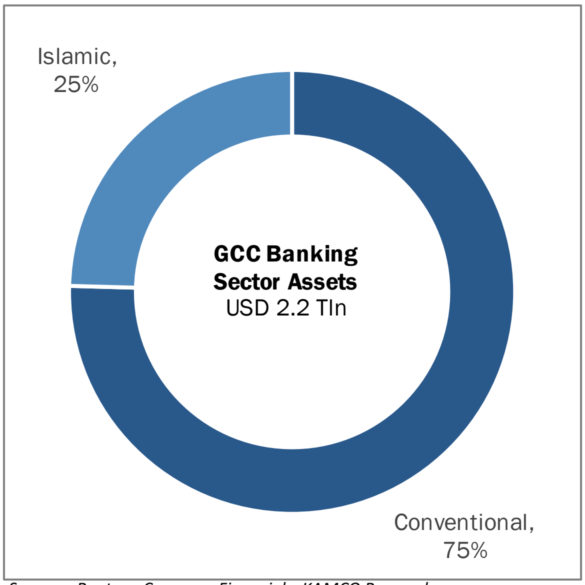
The GCC banking sector boasts strong balance sheet support as customer deposits continued to increase over more than a decade. Total balance sheet assets of the sector stood at USD 2.2 Trillion at the end of 2018 with earning assets reported at an average of 86%. Saudi Arabian banks boasted the biggest banking sector until 2016, however, the UAE has taken over as the largest banking sector over the last two years accounting for 31% of the total assets or USD 674.2 Bn. The top 10 banks in the region accounted for 53% of the total assets for the sector in the GCC. QNB continued to be the biggest bank in the region with a total asset of USD 236.8 Bn or 11% of the sector as of the end of 2018 followed by FAB at 9.4% or USD 203 Bn.

Industry consolidating to form bigger better players

Despite rising profitability, the optimal utilization of earning assets was a key issue with GCC banks as seen from the declining loan-to-deposit ratio over the past two years. In addition, with the economic downturn seen over the past few years led by the decline in oil prices, banks were finding it increasingly difficult to boost lending and overall revenues. Furthermore, with the next wave targeted at fintech, banks need to invest in adding capabilities which includes cutting costs by reducing physical presence as seen in the case of Mashreq Bank. Also, risk weighted exposure with the implementation of IFRS 9 puts further stress on the banking business. Some of the recent transactions in the banking sector included the recently announced merger of KFH and AUB to create the sixth largest bank in the GCC, Oman Arab Bank and Alizz Islamic Bank in Oman, Barwa Bank and International Bank of Qatar to form Lusail Bank and Saudi British Bank and Alawwal Bank in Saudi Arabia.

Positive 'Jaws' ratio shows improving efficiency

Cost optimization and efficiency is the key requirements for one of the most overbanked region. With excessive competition and operating expenses tends to increase in absolute terms that needs to be justified with a higher increase in income. The 'jaws ratio', which is the difference between increase in income and increase in expenses, helps measure how banks are expanding their banking revenue base. For the GCC banks, the ratio remains positive across the six countries but contracted in 2017 primarily due to a steep decline in revenue growth in Qatar and Saudi Arabia. In 2018, however, the pattern reversed to show strong jaws ratio across the countries with Qatar and Saudi Arabia leading the growth. Qatari banks have in fact lowered operating expenses over the past two years.



Source : Reuters, Company Financials, KAMCO Research

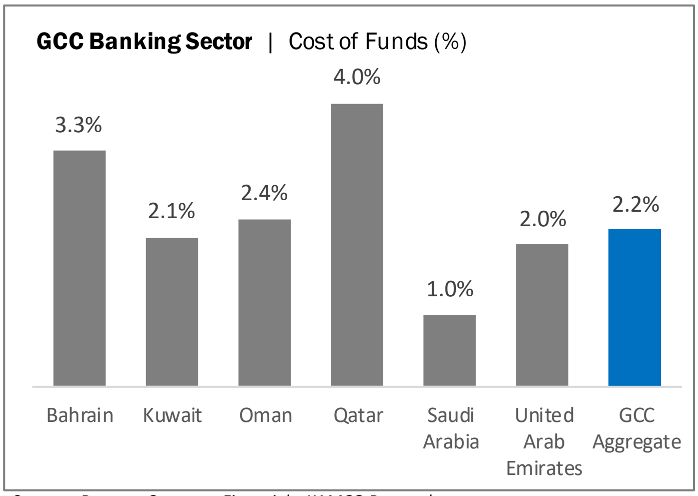
Islamic vs. Conventional Banks

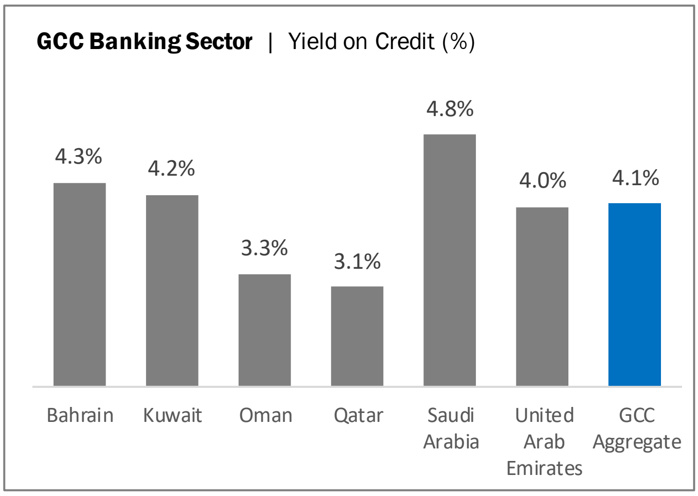
Both Islamic and conventional banks in the region have shown growth in assets over the years, although over the past two years, conventional banks have growth at a slightly faster pace as compared to Islamic banks. Nevertheless, the 5-year CAGR for Islamic banks was marginally better at 7.8% as compared to 6.9% for the conventional lenders in the GCC. Saudi Arabia

Highlights - GCC Banking Sector

accounted for the biggest share of Islamic banking assets at USD 168.7 Bn in 2018 followed by UAE at USD 130 Bn. The overall share of Islamic listed banks in the region's total banking sector assets has remained almost stable at around 25%.

Improving Yield on Credit



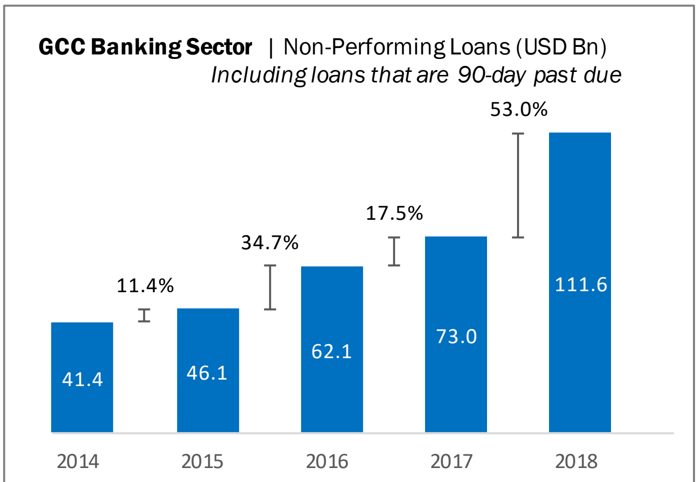


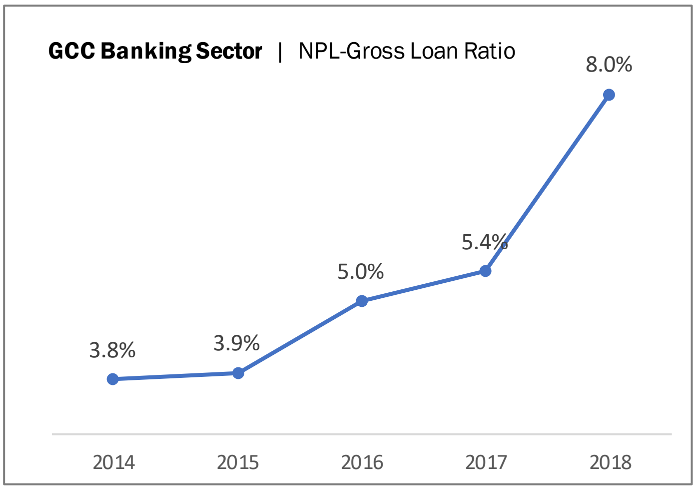
Source : Reuters, Company Financials, KAMCO Research

The yield on credit that measures the net return on loans and advances by a bank has shown marginal improvement over the past two years for the aggregate GCC banking sector. Recorded at 4.8% in 2018, the ratio was the highest in Saudi Arabia followed by Bahrain and Kuwait at 4.3% and 4.2%, respectively. On the other hand, cost of funds has increased by almost 40 bps during 2018, one of the highest for the sector over the years.

Impact of IFRS 9 would result in asset quality deterioration

GCC banks are in the process of implementing IFRS 9 that has resulted in the steep jump in NPL across the countries. The NPL ratio for the aggregate GCC banking sector increased from 5.4% in 2017 to 8% in 2018 with bad loans (including 90-day past due loans) increasing from USD 73 Bn in 2017 to USD 111.6 Bn in 2018. The ratio is expected to deteriorate if the economy fails to show progress in the near term as any slowdown would result into higher bad loans and with the new criteria of IFRS 9, loans could quickly fall under the Stage 3 category of impaired loans.



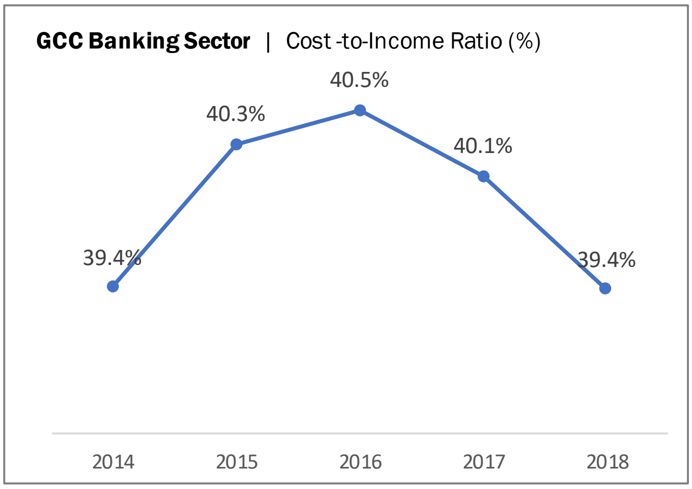


Source : Reuters, Company Financials, KAMCO Research

Highlights - GCC Banking Sector

Improving Cost-to-Income Ratio

Cost efficiency improvement measures implemented by GCC banks has resulted in a visible improvement in the sector's cost to income ratio. The ratio has seen declines over the last two years and was recorded at 39.4% in 2018, a y-o-y improvement of 70 bps. In terms of country split, Qatar had the lowest ratio at 32.1% while Bahrain and Omani banks were the highest in the GCC.



Source : Reuters, Company Financials, KAMCO Research

Strong credit rating profile

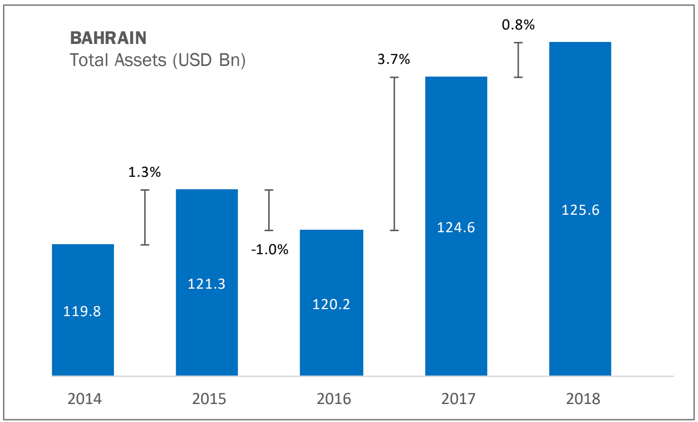
The robust balance sheet of GCC banks along with adequate coverage ratios resulted in an above average credit ratings for the sector. The average rating of GCC banks stood at an investment grade of 'A', according to our calculations. This also came as a result of a majority of the countries in the GCC being in the investment grade category. Strong government support to local banks also resulted in higher credit ratings. Nevertheless, the concentration of lending to specific sectors like Real Estate and to government initiated projects is a cause of concern for the sector.

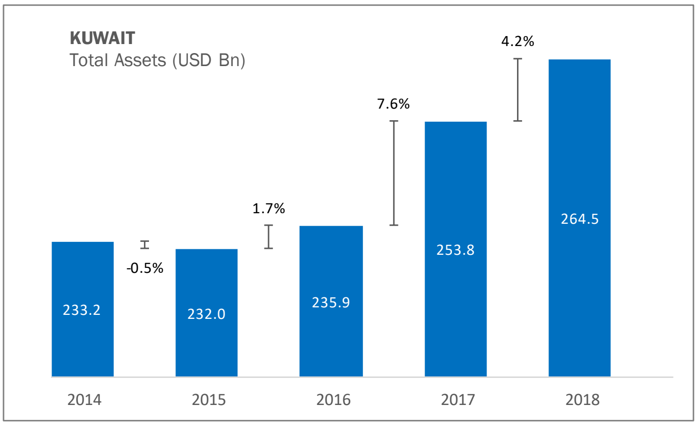
Outlook

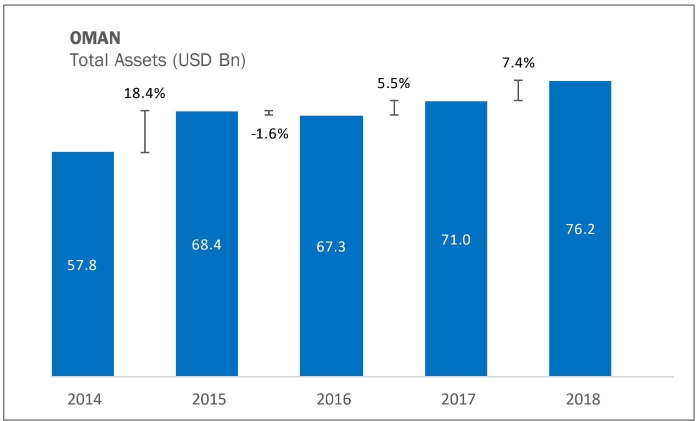
We see a number of positives for the GCC banking sector that help to mitigate key downside risks. Some of these risks include excessive exposure to the real estate sector. The real estate sector continues to face challenges, especially in the UAE, due to continued oversupply and the near term outlook for the sector shows continued downward pressure. In addition, governments continue to be the primary originator of key projects in the region. With the excessive dependence on oil revenues, the government may prioritize some sectors and shelve or delay the non-critical ones as seen in 2015 when oil prices reached multi-year lows. Moreover, the implementation of IFRS 9 is expected to affect the asset quality on an increasing scale over the next couple of years. Banks would have to take rising impairments and classify higher bad loans. Overall, the economic environment, although expected to marginally improve in the near term, continues to exert pressure on the banking sector forcing banks to look to other revenue generating opportunities or ways of optimizing costs by reducing physical presence or merging with other players in the industry.

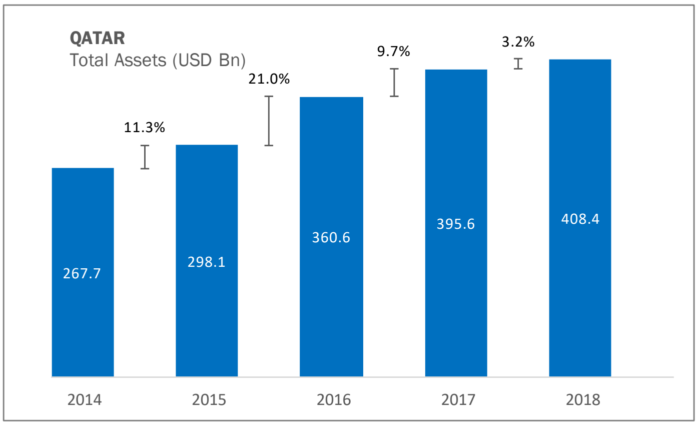
That said, the positives that tends address some of the aforementioned concerns include the strong balance sheet of the sector that has comfortably absorbed impairments and bad loans in the recent crisis. On the economic front, GCC countries have drafted a number of long term plans and are implementing it on an faster pace. The governments have tapped the debt market to fund these projects in light of declining oil revenues. Some of the near term projects include the Expo 2020 in Dubai and the Fifa World Cup in 2022 in Qatar. These events have the potential to provide a big boost to the concerned economies and thereby support the banking sector. Also, the implied government support to banks in the region helps the banks raise debt at relatively better rates as seen from the recent round of bond issuances. The government and the central banks have also initiated a number of credit boosting measures aimed at reviving the economies that includes credit guarantee schemes, support to the small and medium enterprises in the region, and the introduction of bankruptcy law. Furthermore, the introduction of fintech in banking with new payment gateways and increasing digitization should help in improving margins and profitability in the sector.

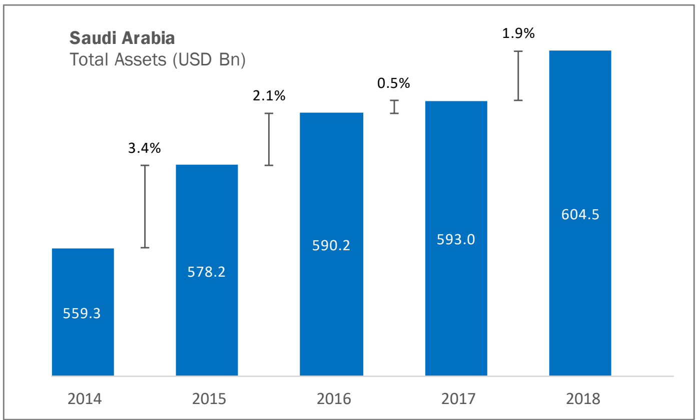
GCC Banking Sector : Total Assets

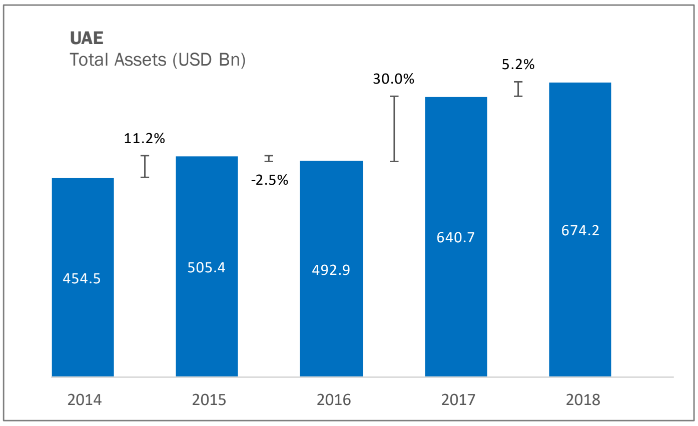


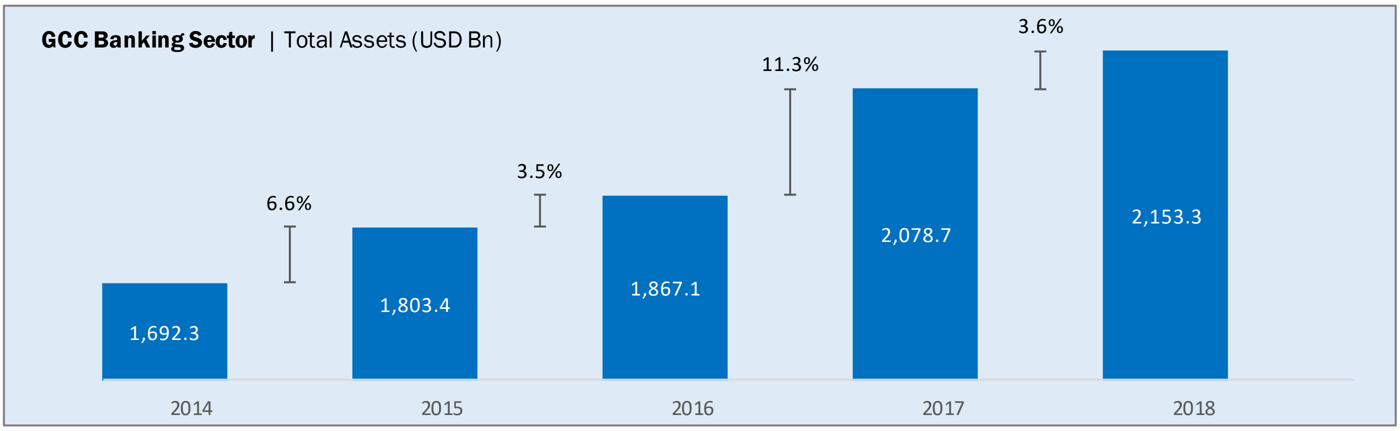






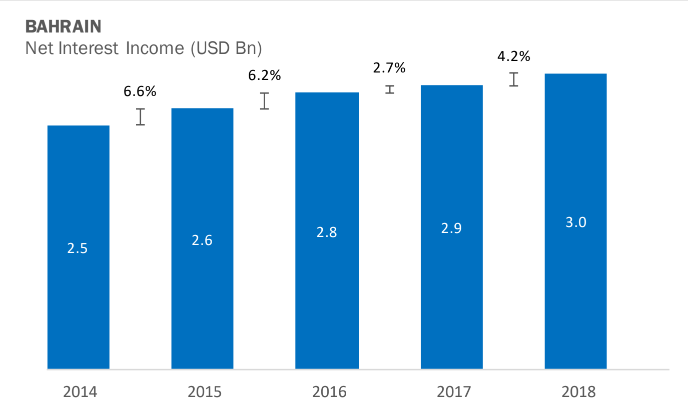


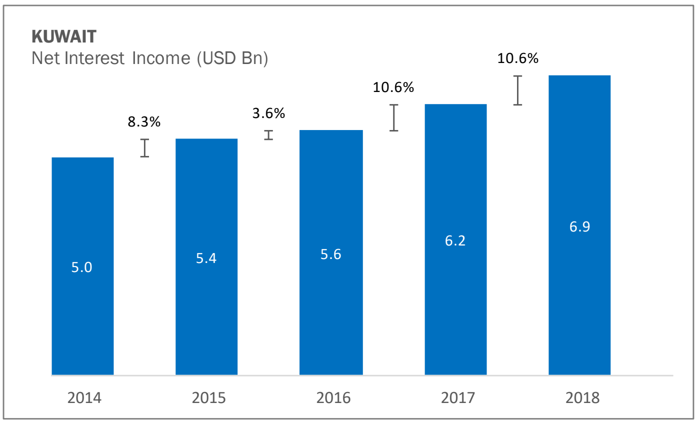


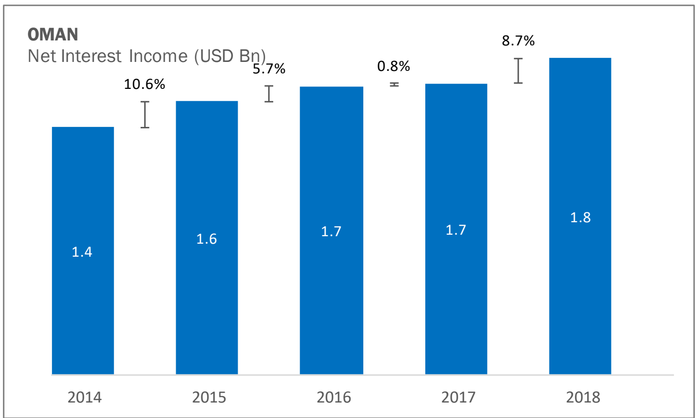


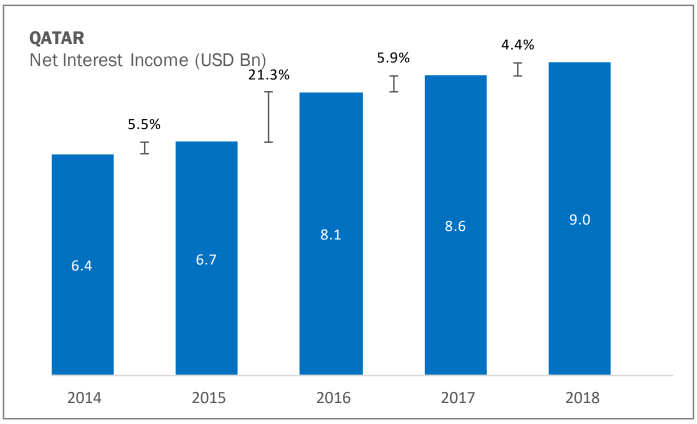
Source : Reuters, Company Financials, KAMCO Research

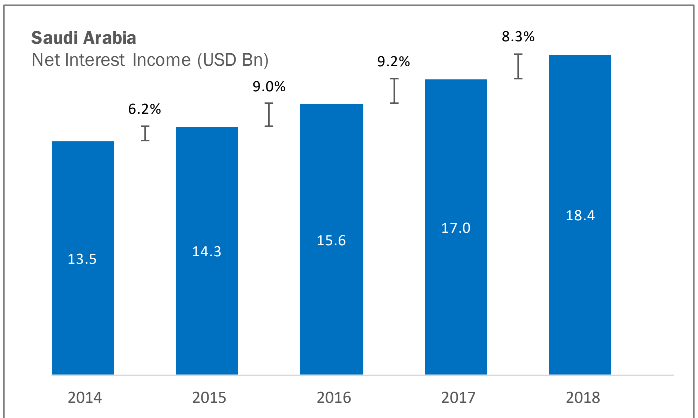
GCC Banking Sector : Net Interest Income

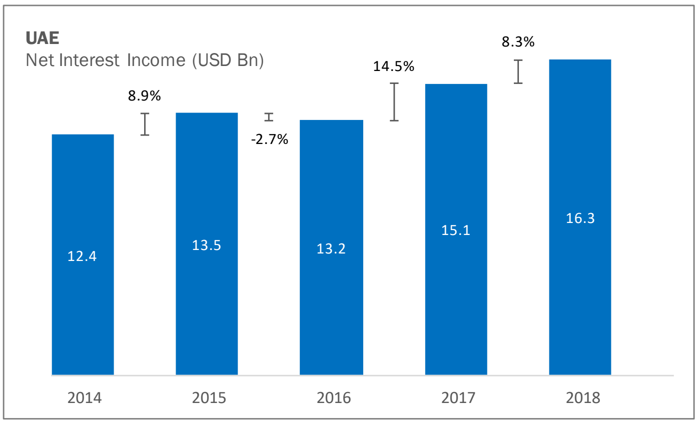


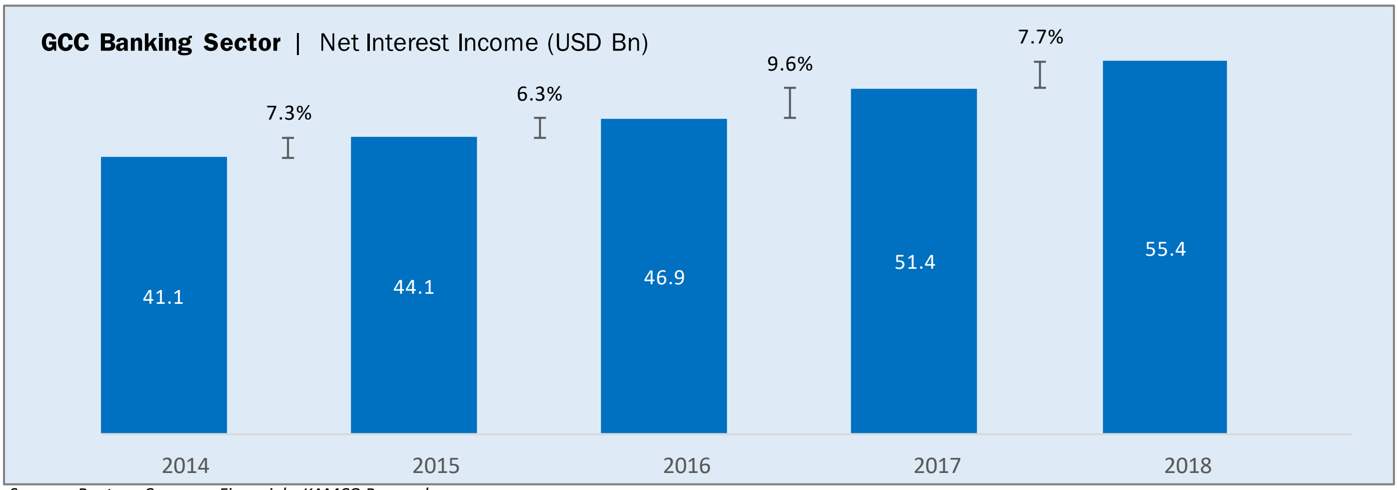






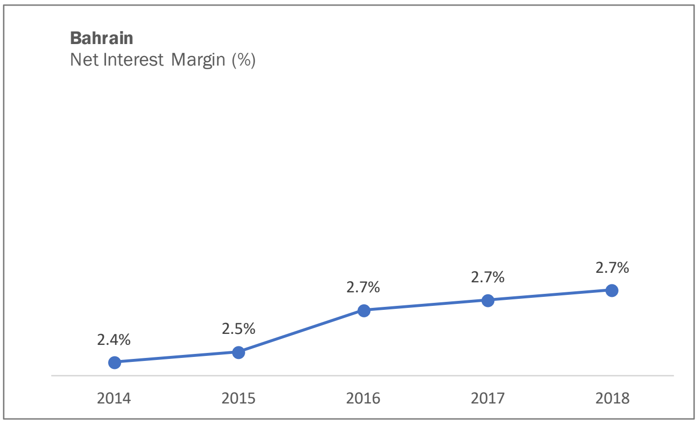


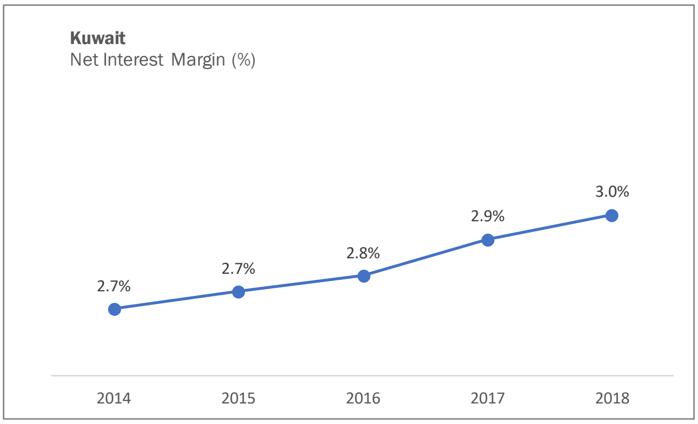


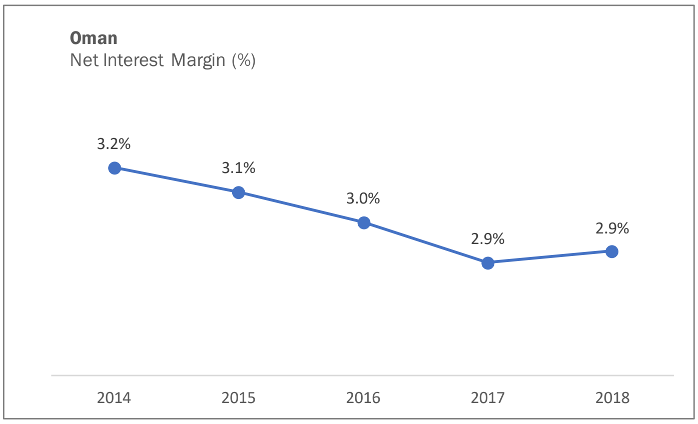


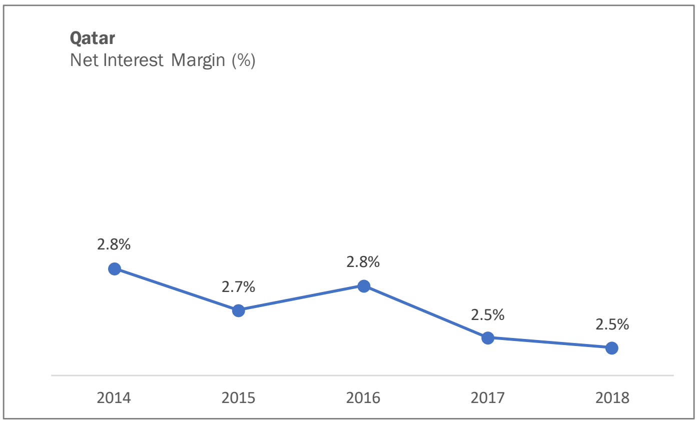
Source : Reuters, Company Financials, KAMCO Research

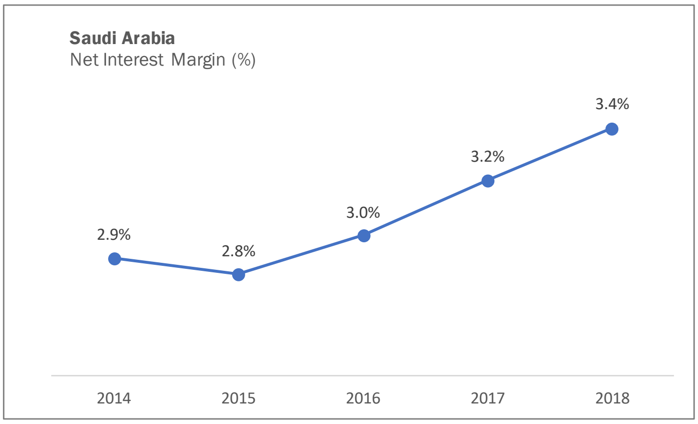
GCC Banking Sector : Net Interest Margin

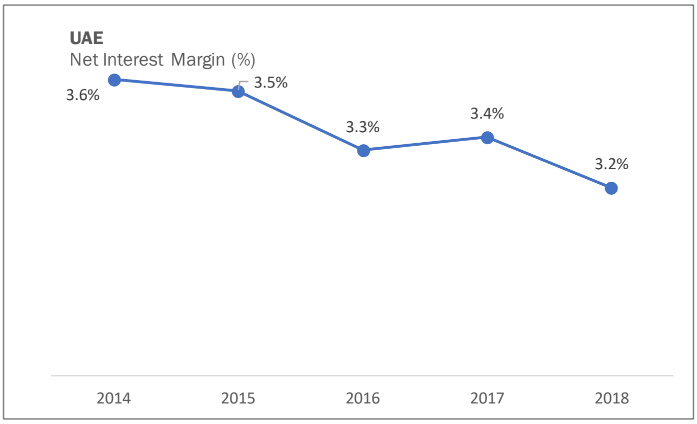


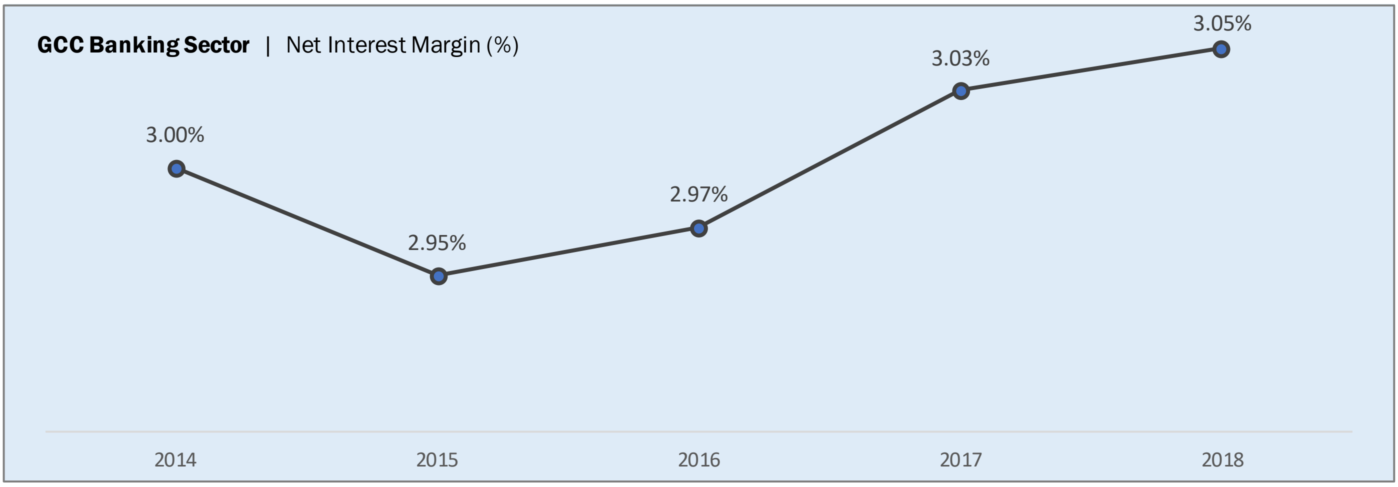






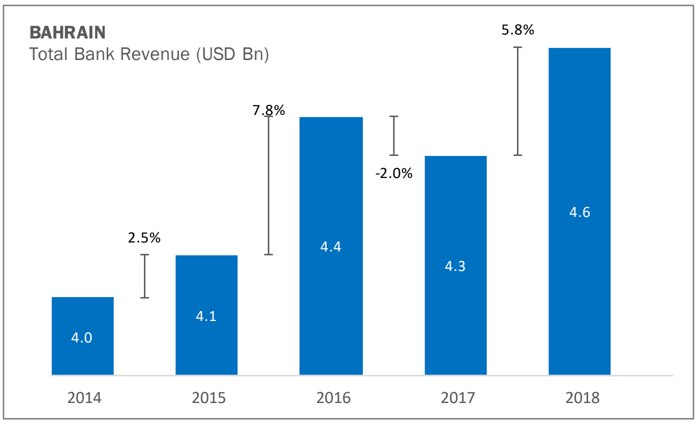


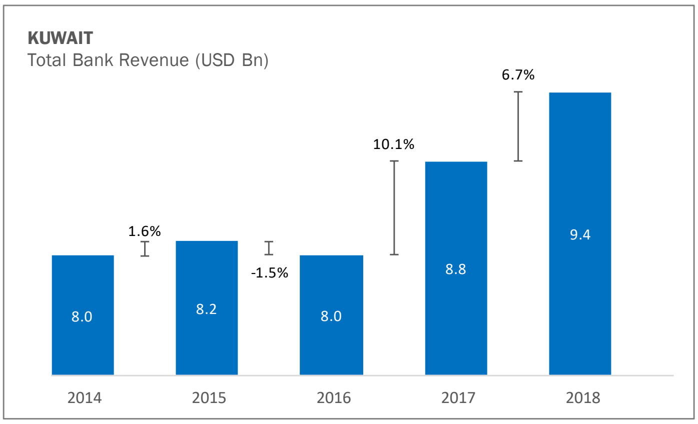


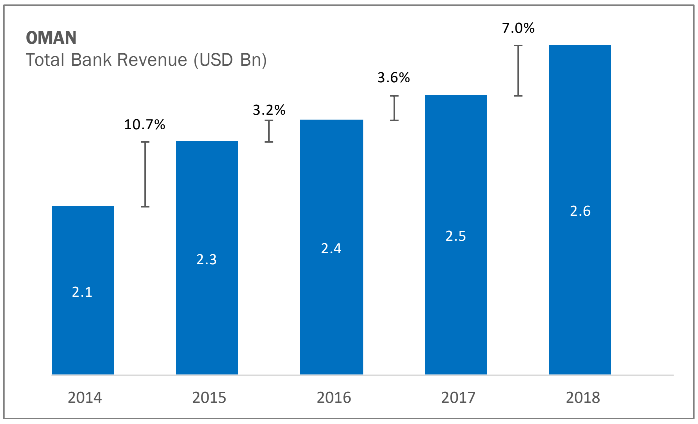


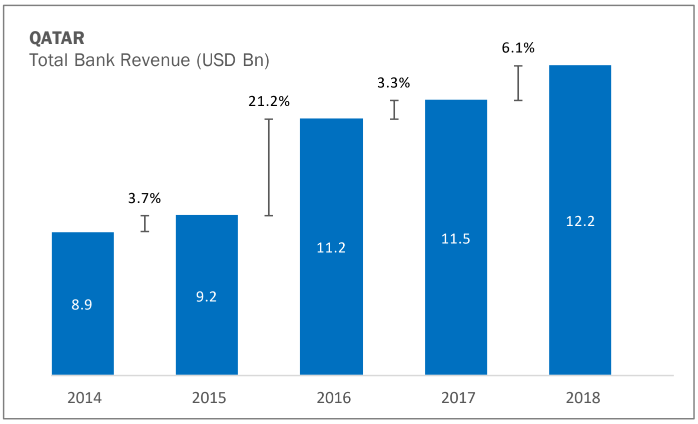
Source : Reuters, Company Financials, KAMCO Research

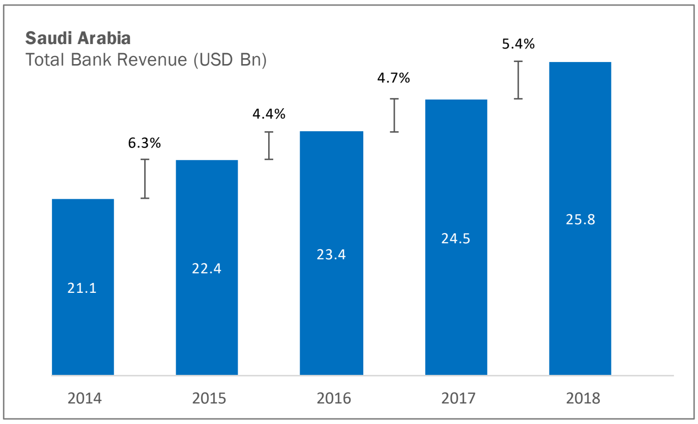
GCC Banking Sector : Total Revenue

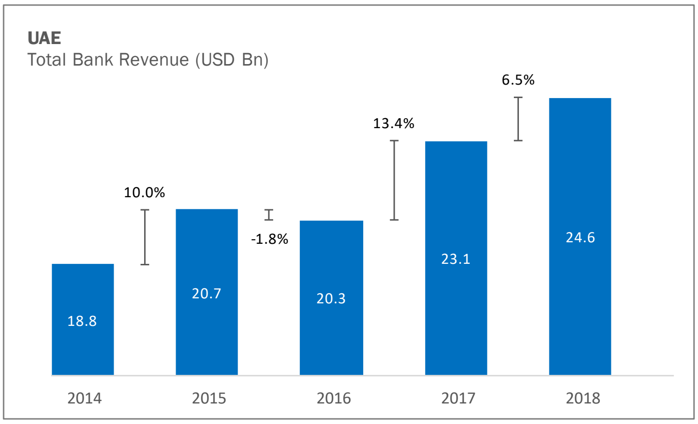


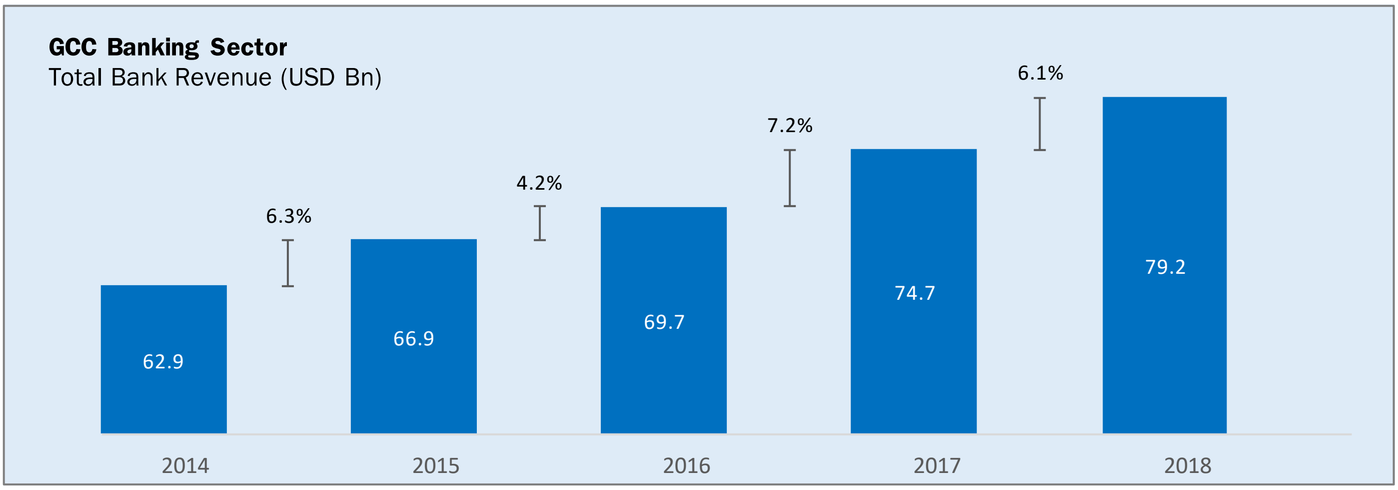






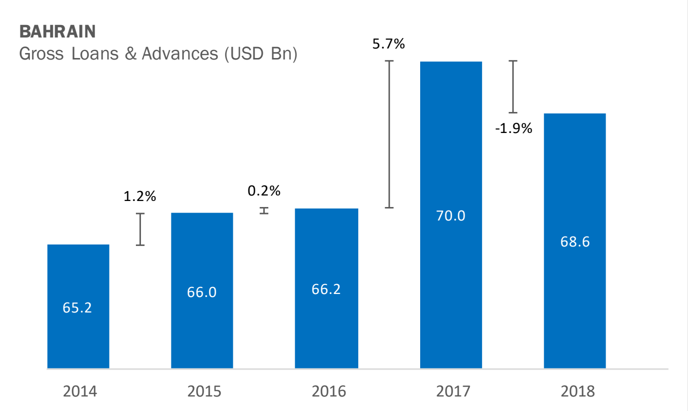


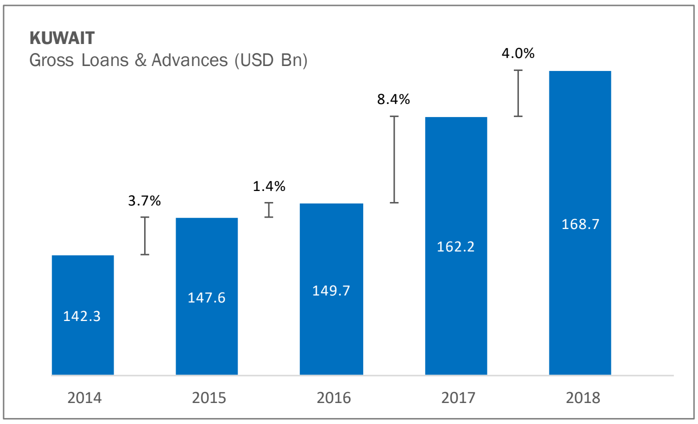


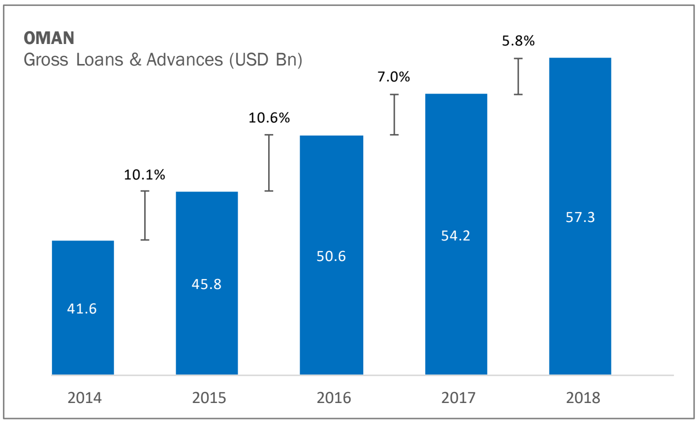


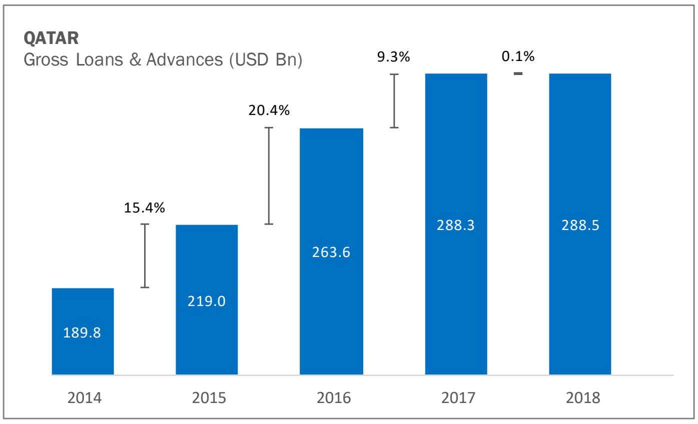
Source : Reuters, Company Financials, KAMCO Research. Note : Total Bank Revenue includes NII + Non-Interest Income

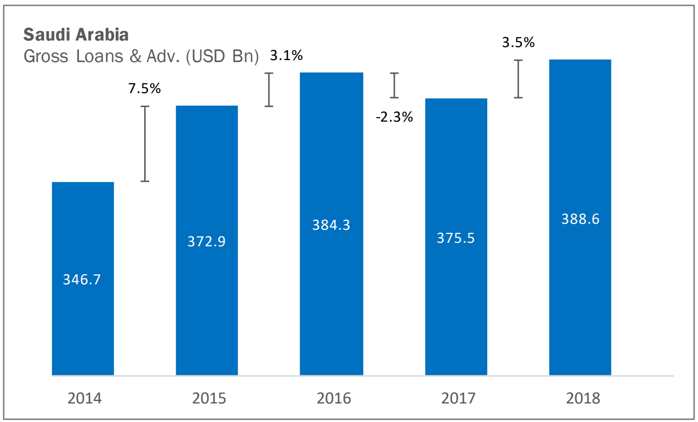
GCC Banking Sector : Gross Loans & Advances

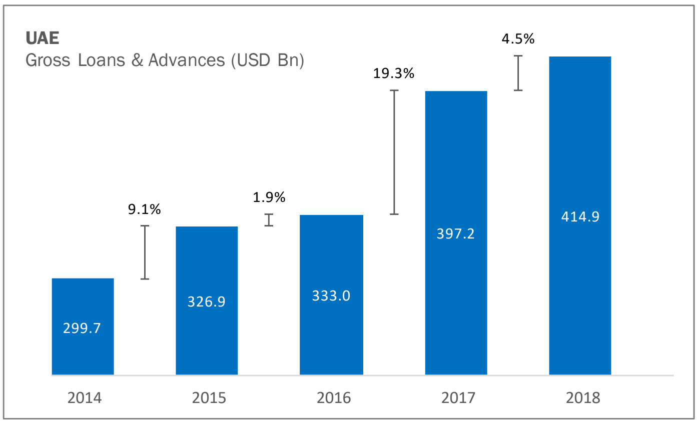


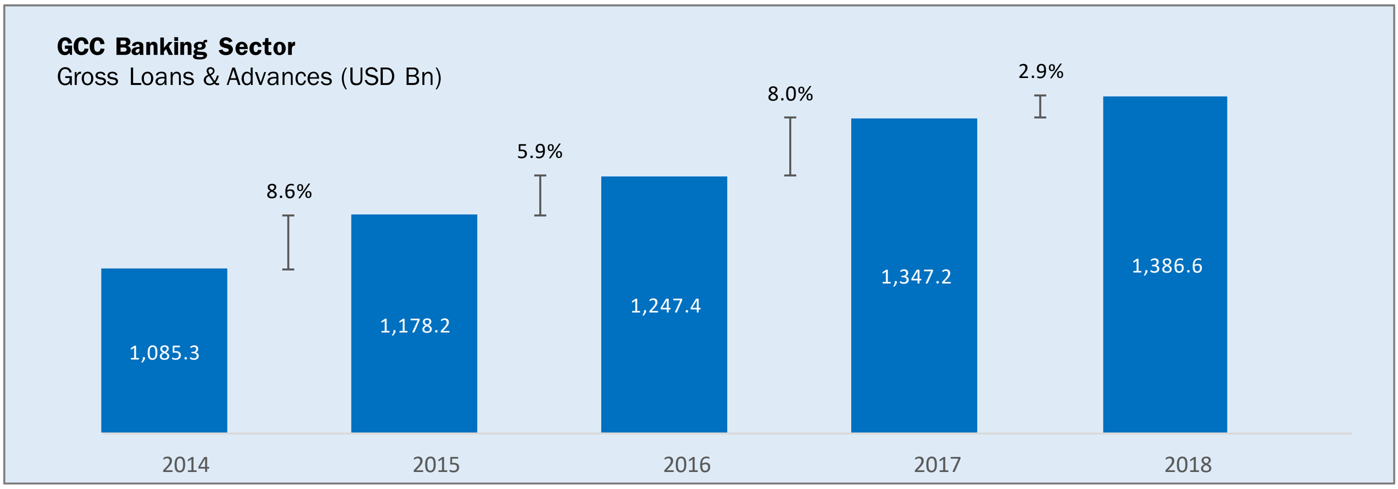






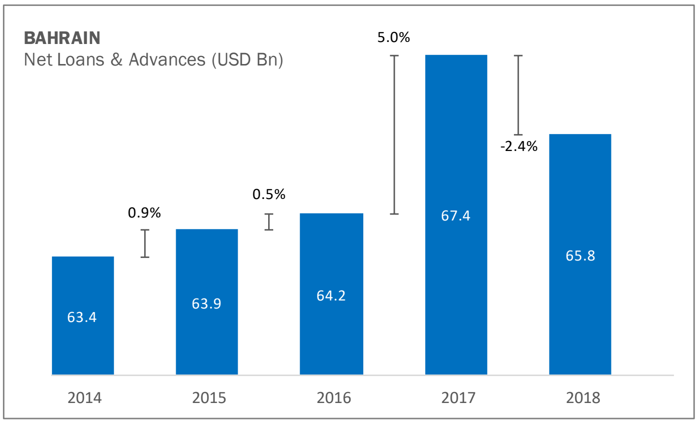


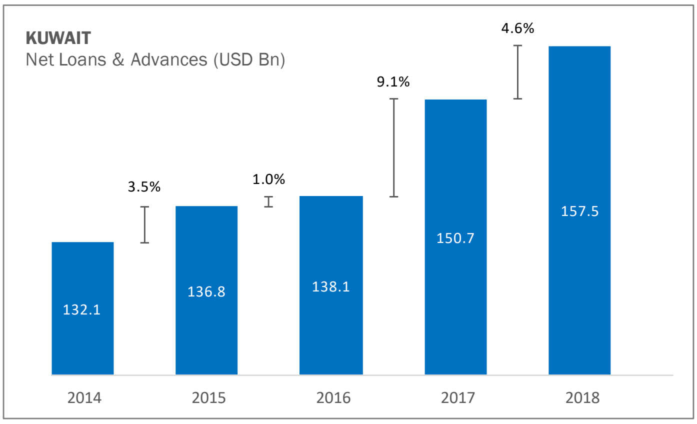


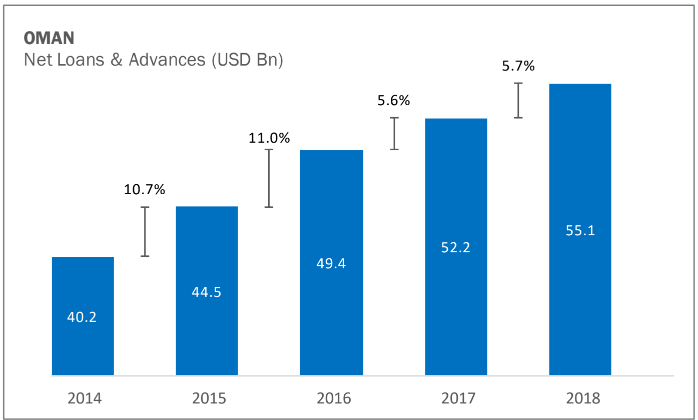


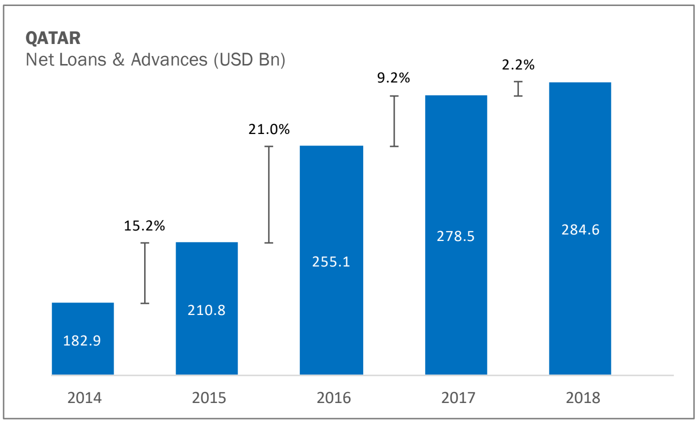
Source : Reuters, Company Financials, KAMCO Research

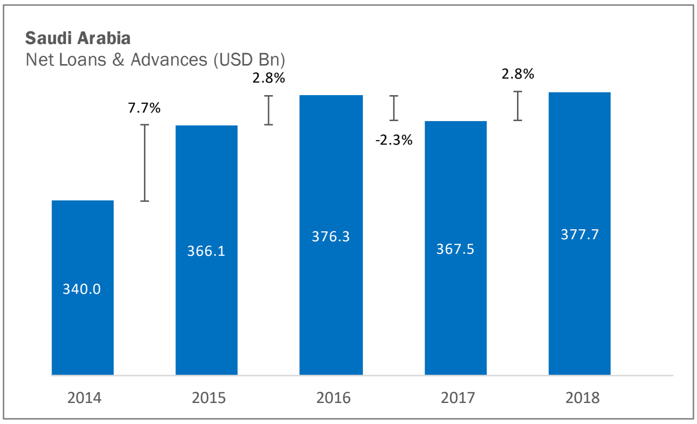
GCC Banking Sector : Net Loans & Advances

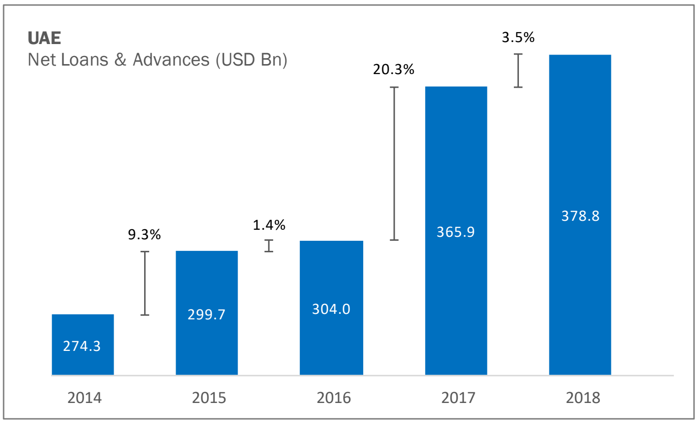


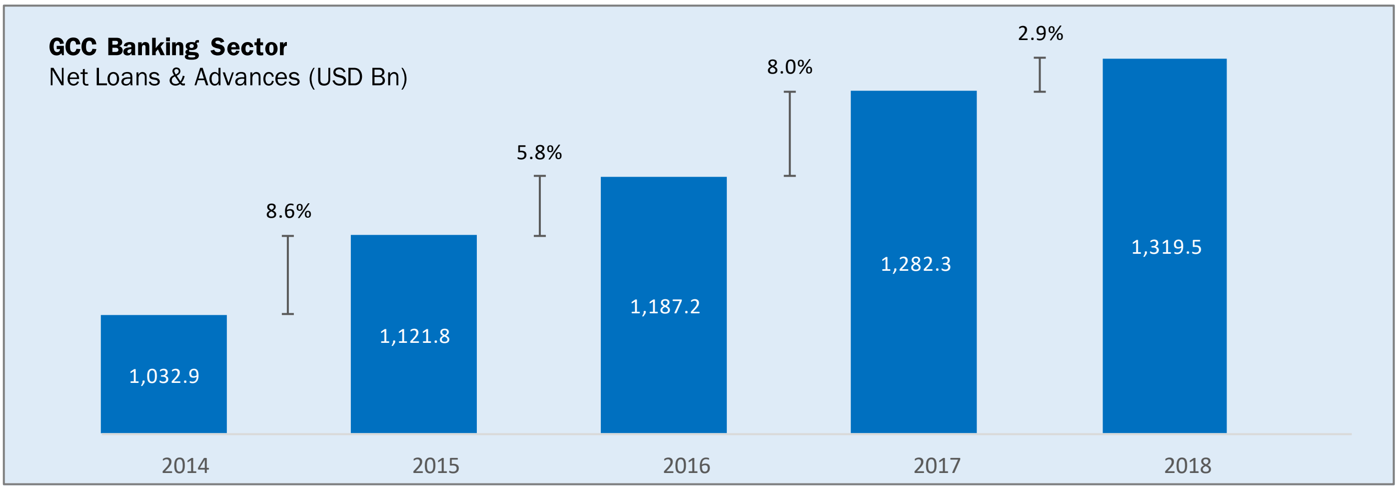






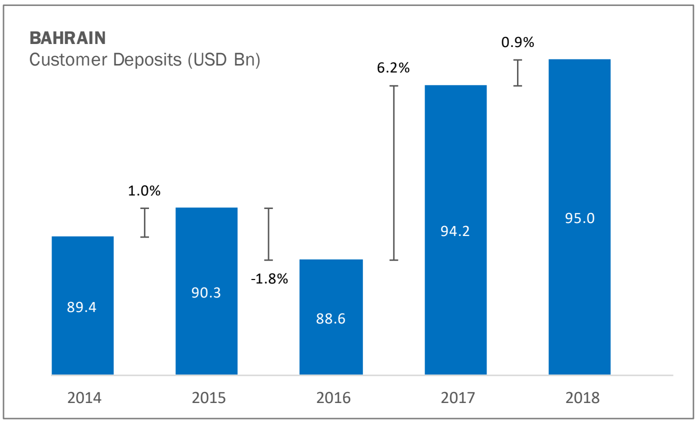


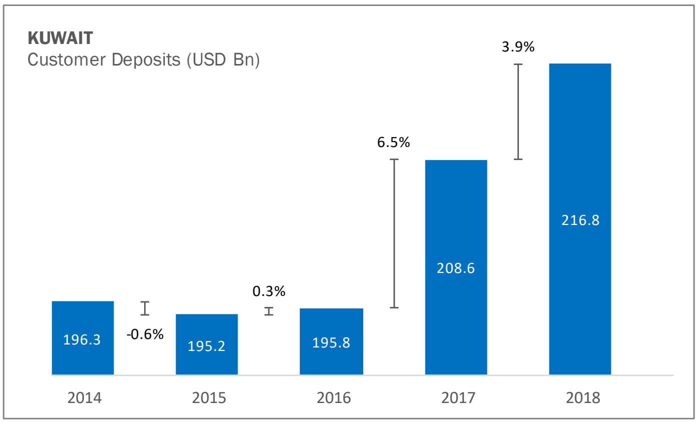


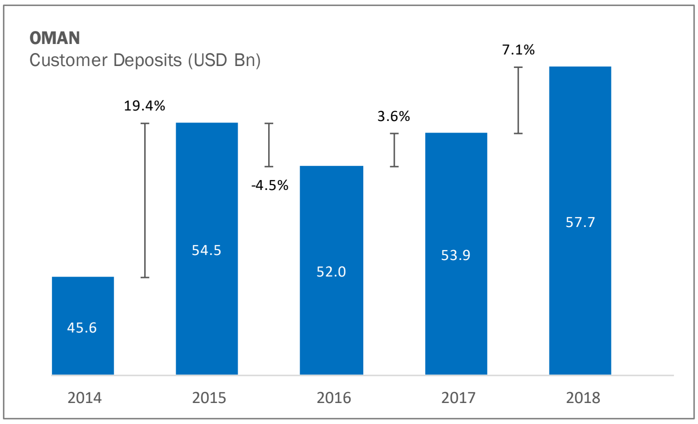


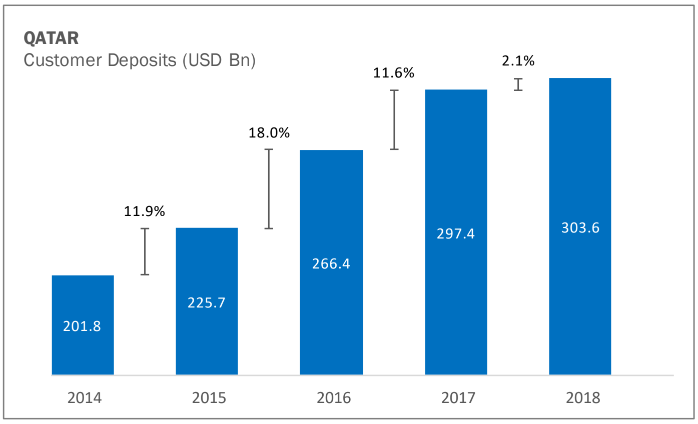
Source : Reuters, Company Financials, KAMCO Research

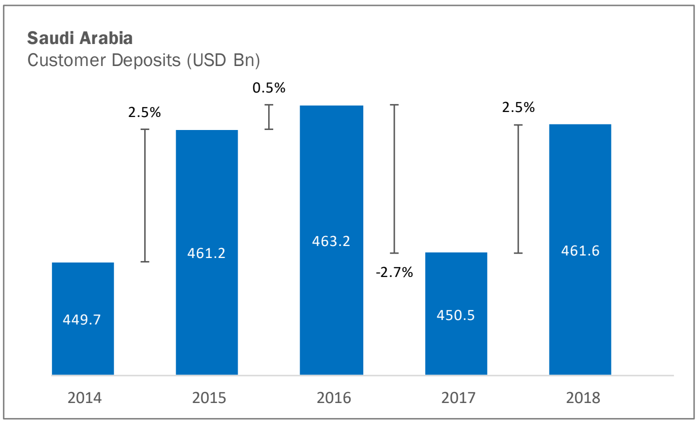
GCC Banking Sector : Customer Deposits

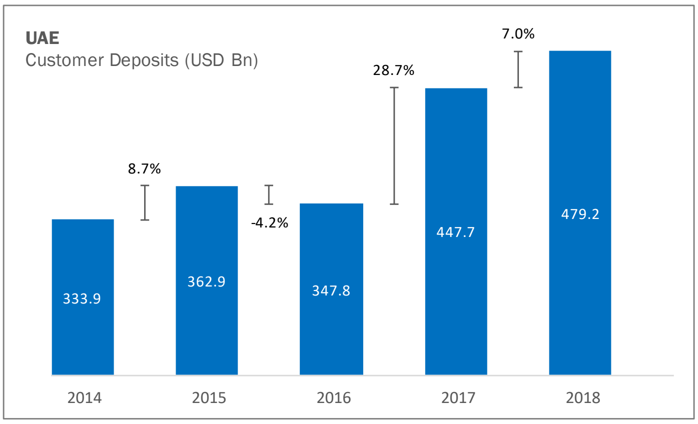


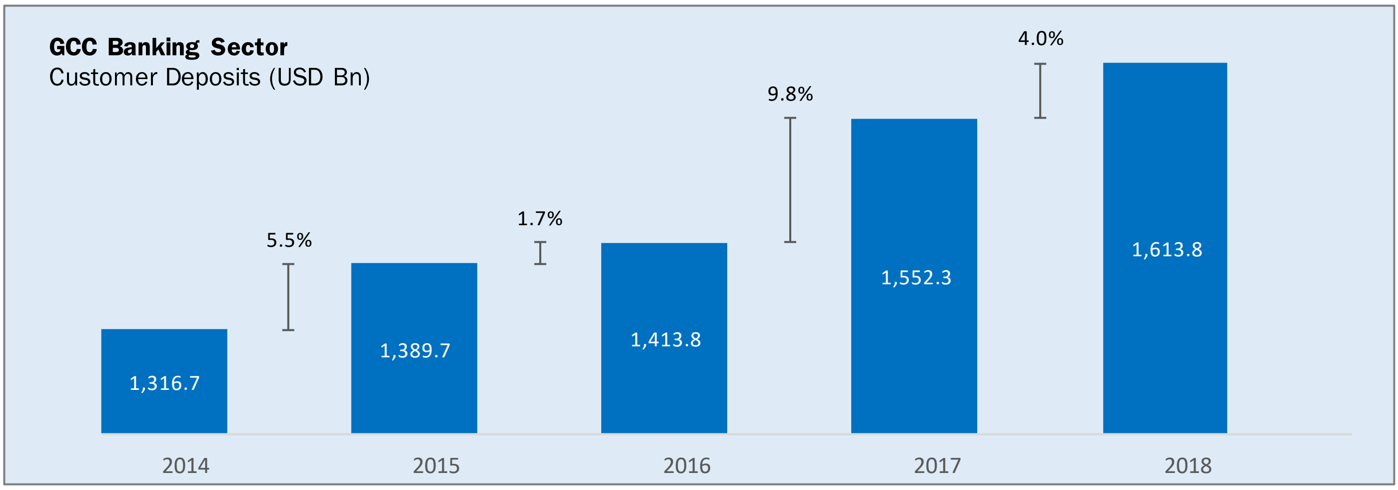






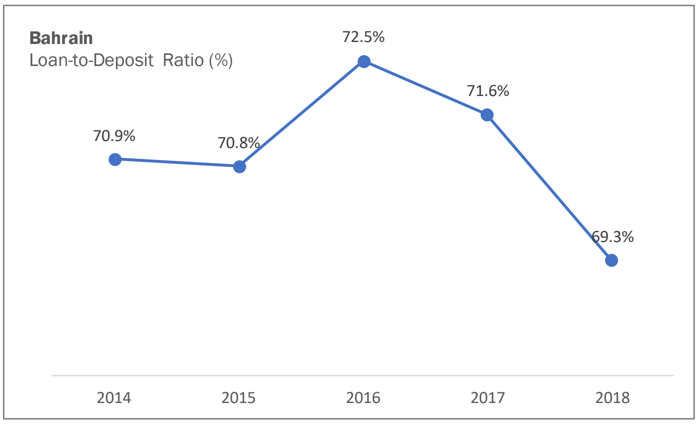


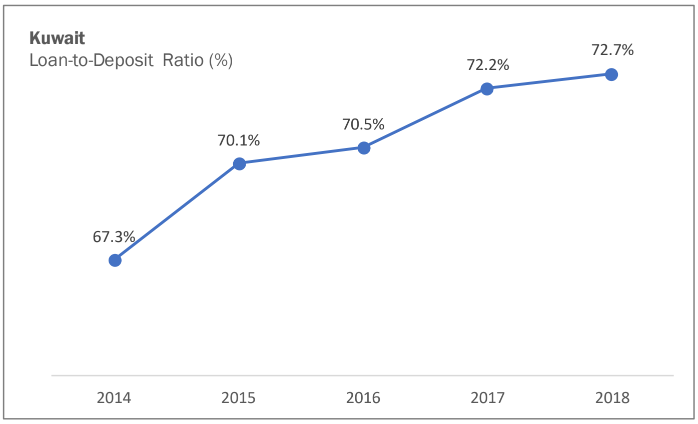


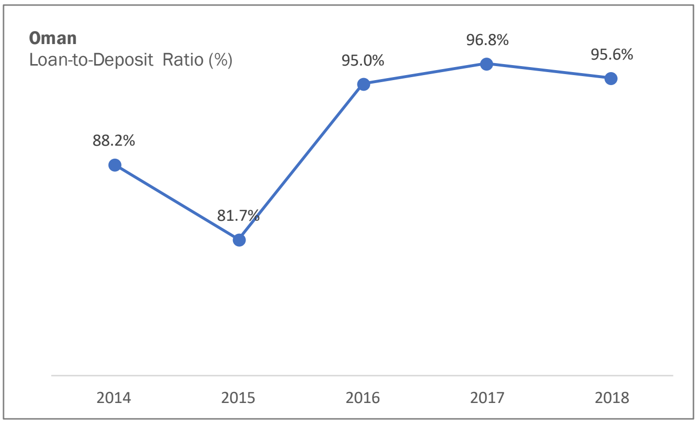


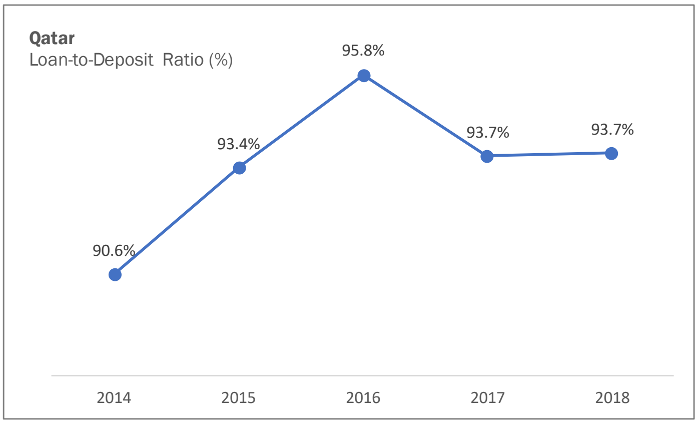
Source : Reuters, Company Financials, KAMCO Research

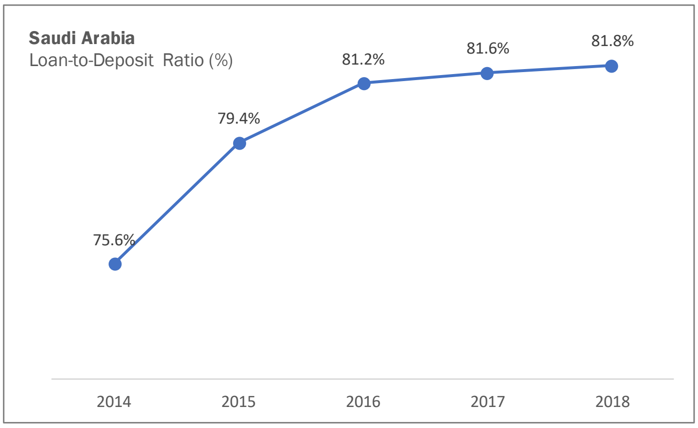
GCC Banking Sector : Loan-to-Deposit Ratio

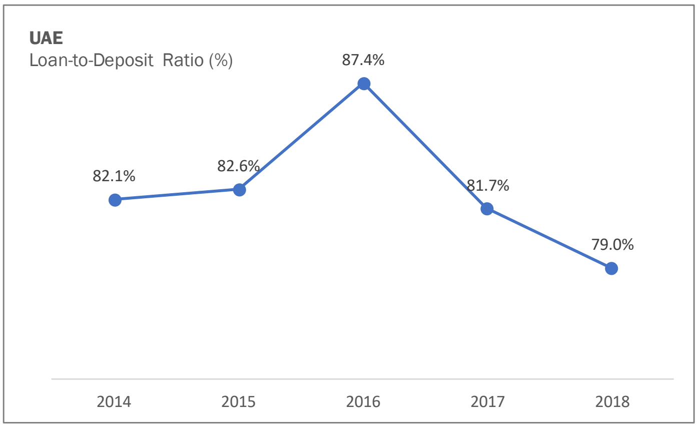


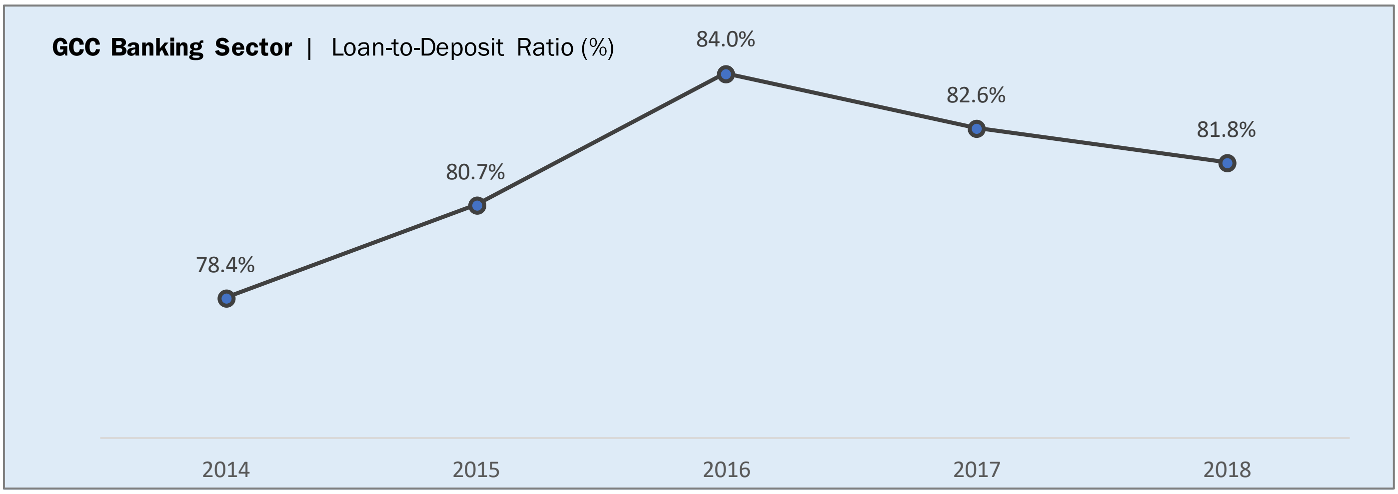






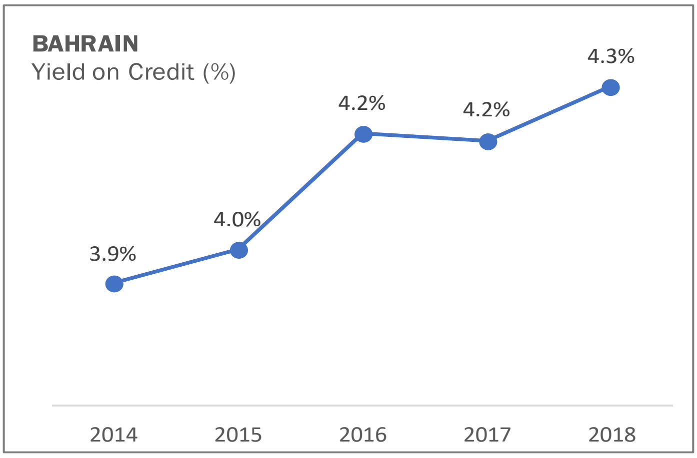


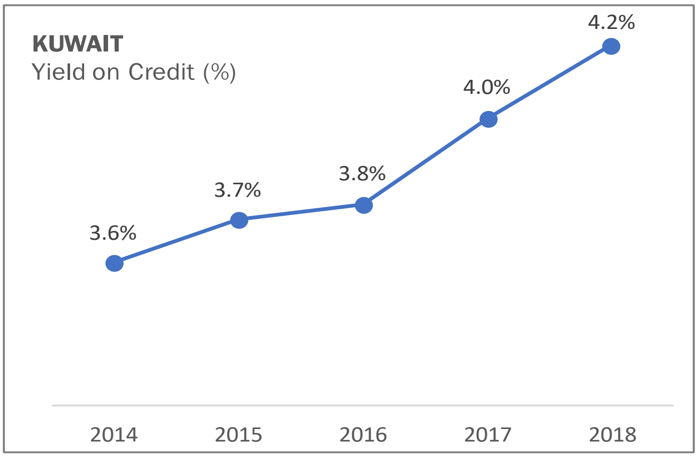


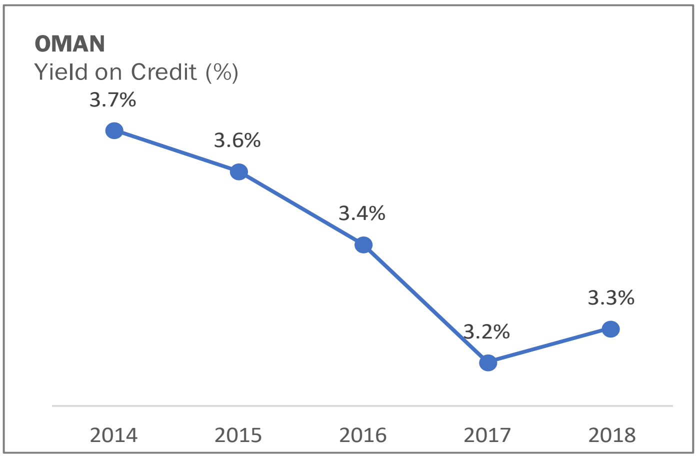


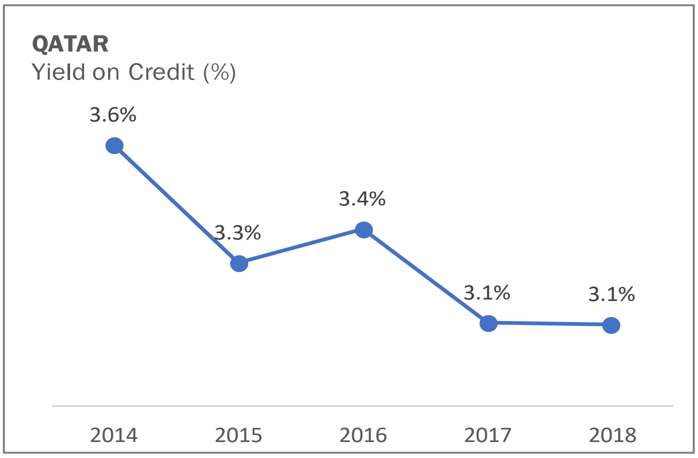
Source : Reuters, Company Financials, KAMCO Research

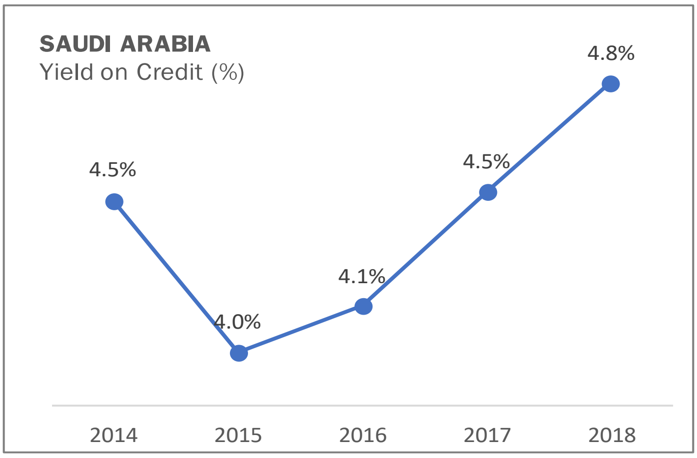
GCC Banking Sector : Yield on Credit

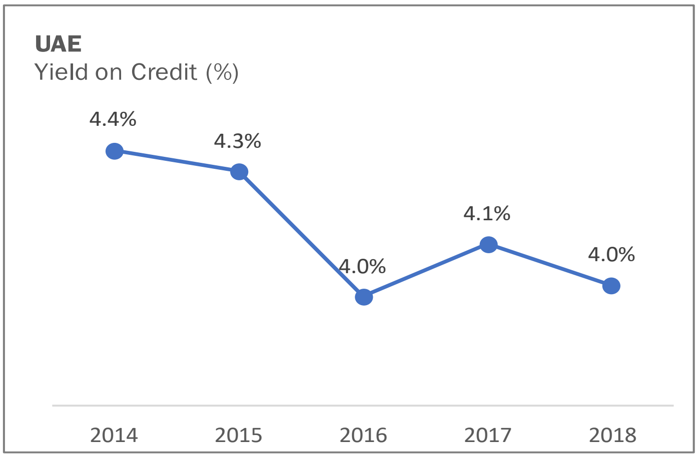


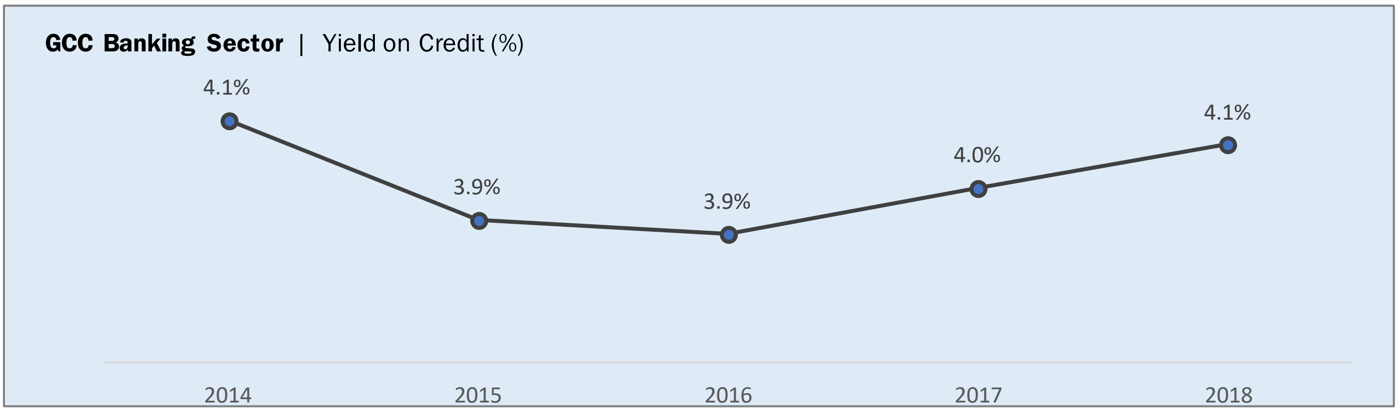






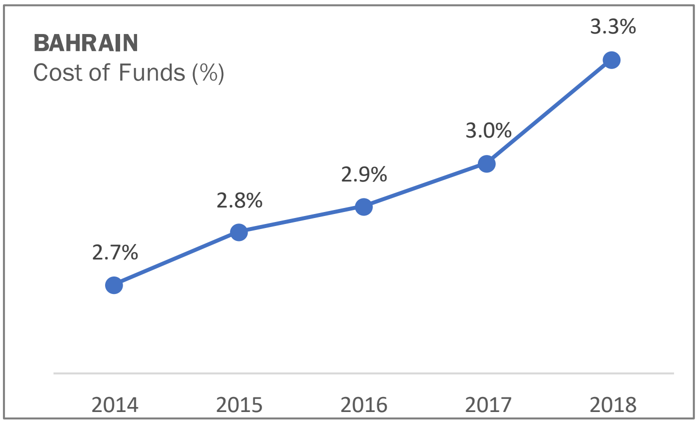


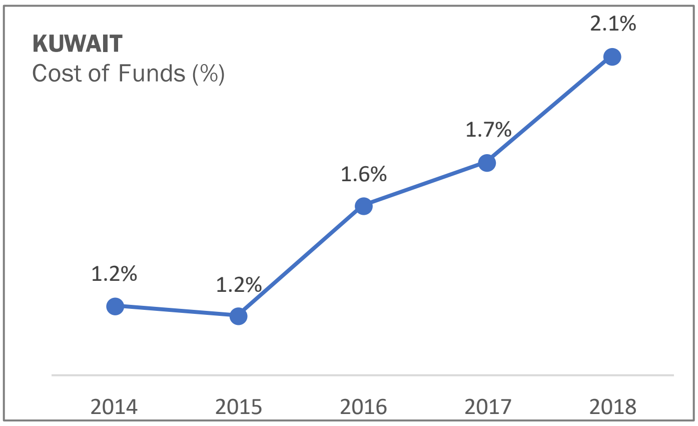


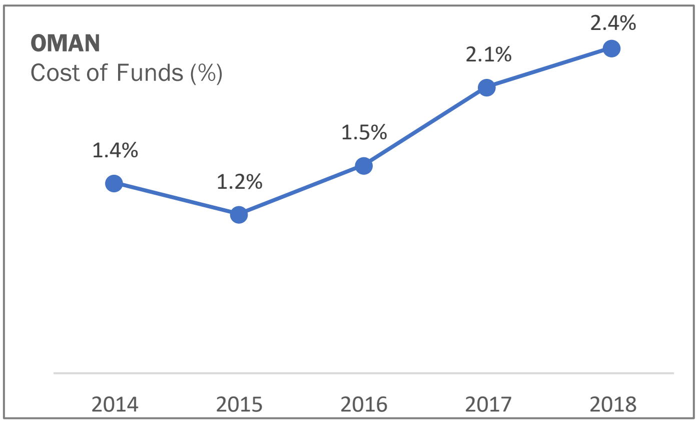


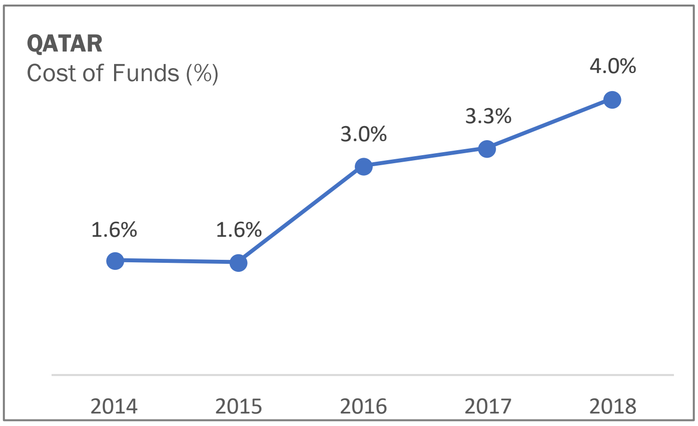
Source : Reuters, Company Financials, KAMCO Research

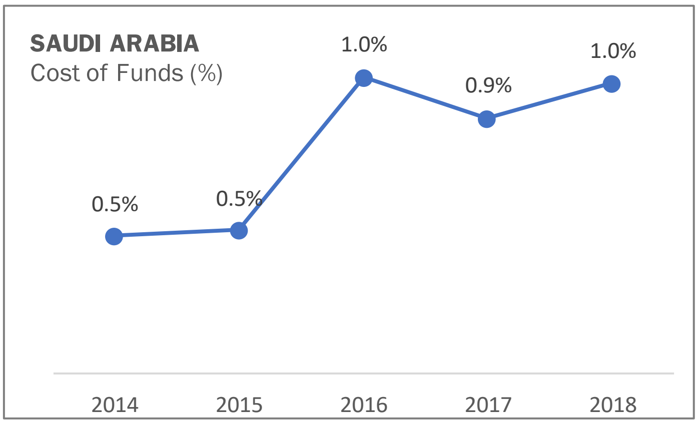
GCC Banking Sector : Cost of Funds

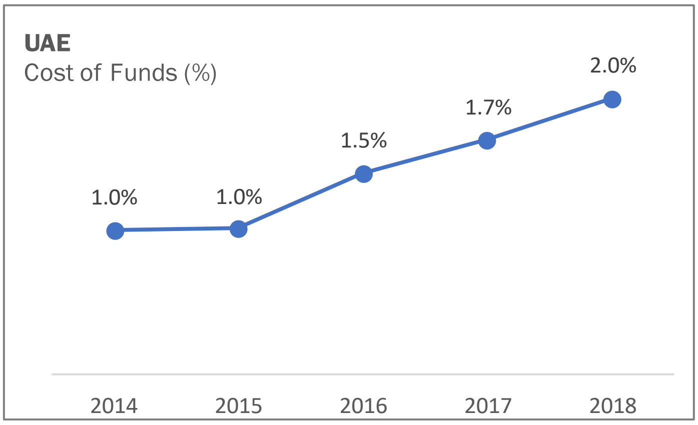


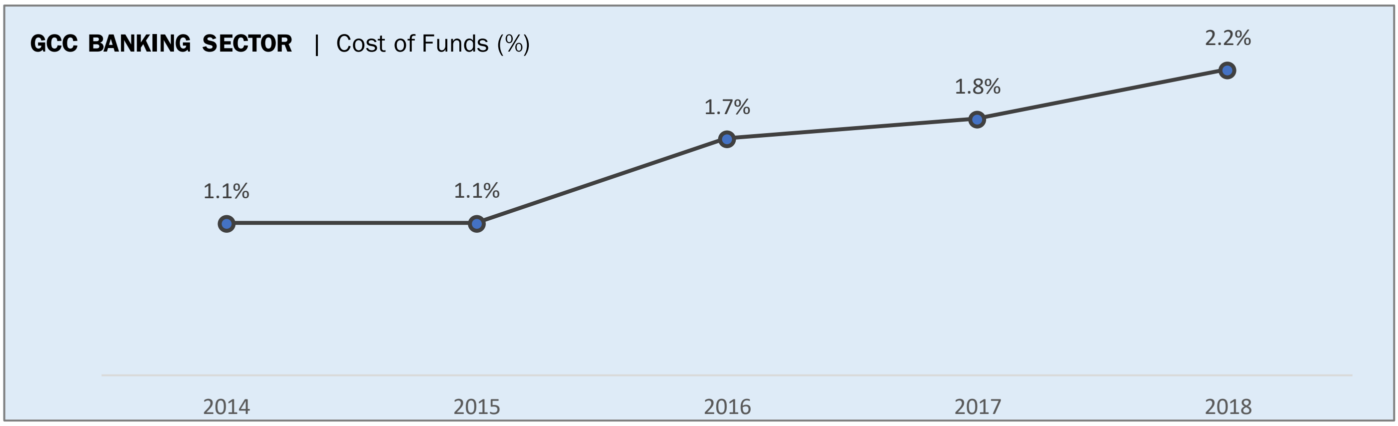






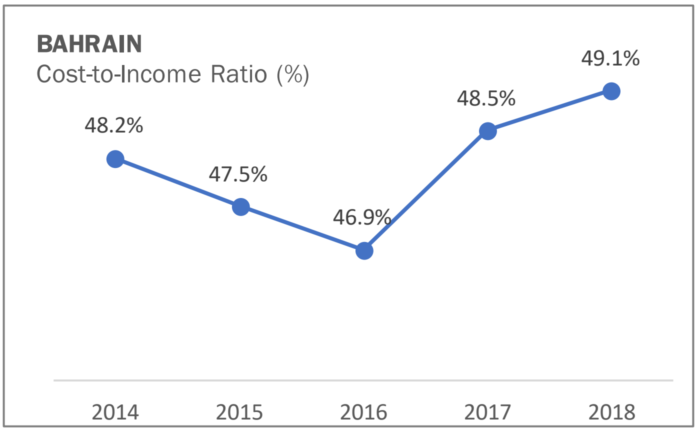


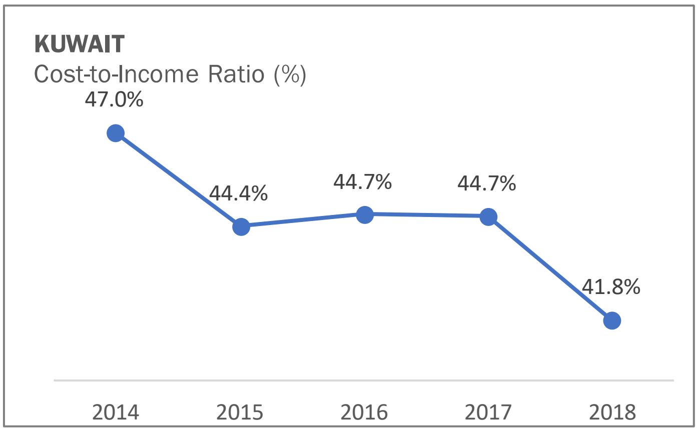


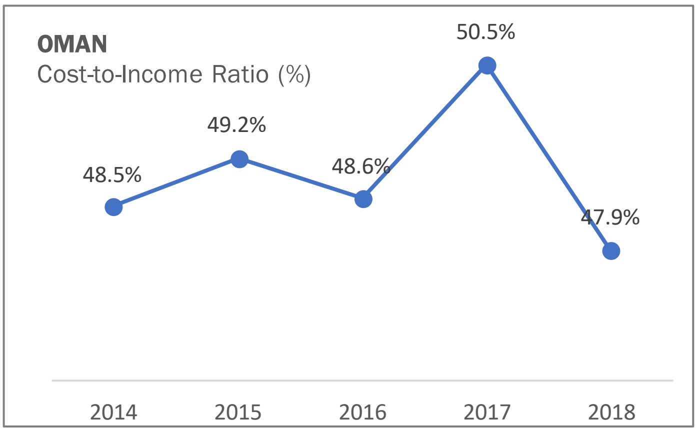


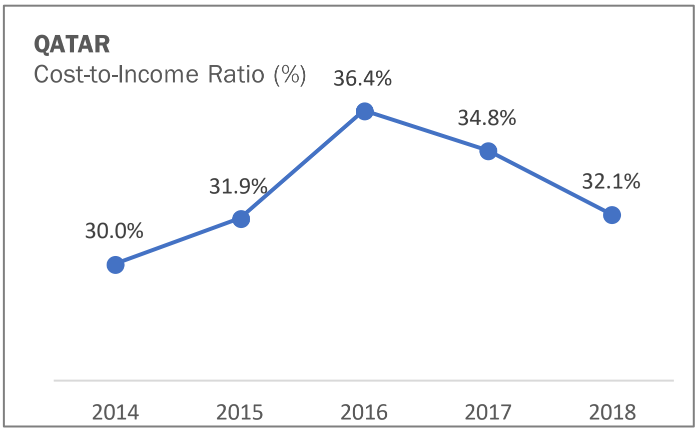
Source : Reuters, Company Financials, KAMCO Research

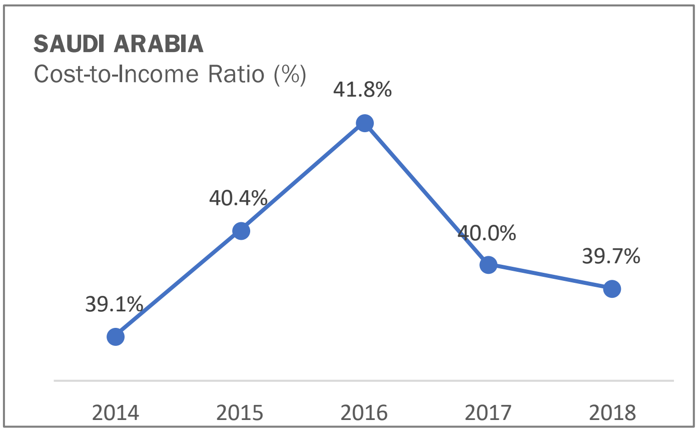
GCC Banking Sector : Cost-to-Income Ratio

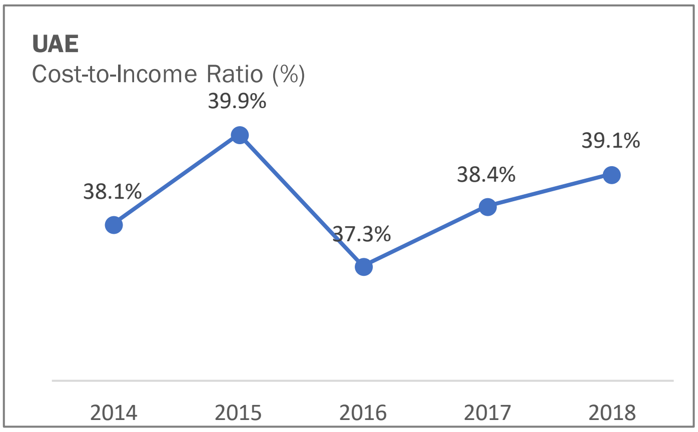


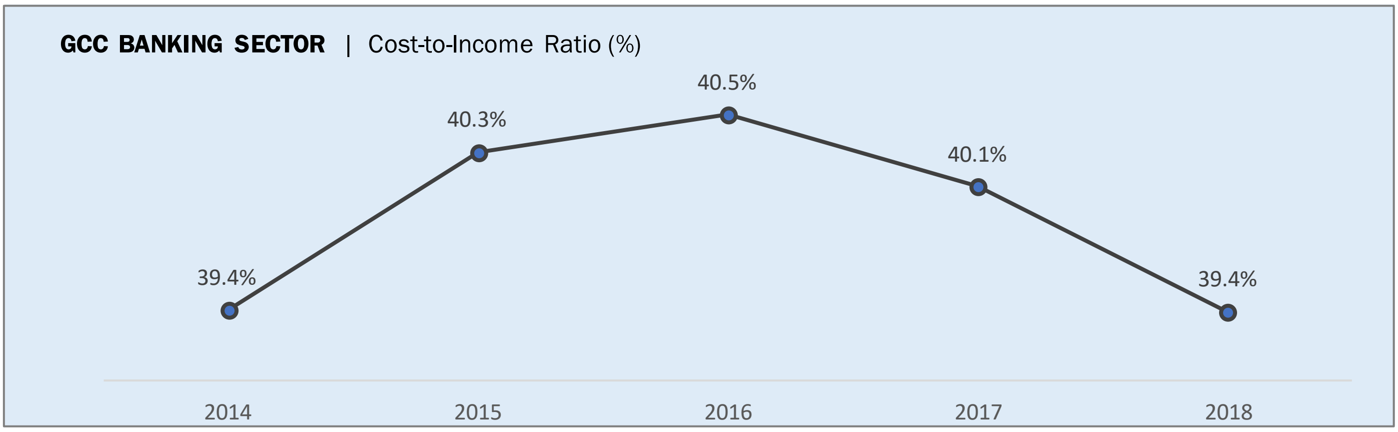












Source : Reuters, Company Financials, KAMCO Research

GCC Banking Sector : Market Data

Name	Country	M-CAP (USD Bn)	Price (LCL)	P/E (x)	P/BV (x)	Div Ind Yield (%)	YTD-19 Returns	3-Yr Avg Tot Return	5-Yr Avg Tot Return	10-Yr Avg Tot Return
AHLI UNITED BANK B.S.C	Bahrain	7.3	0.830	10.7	2.0	5.5	40.8%	27.9%	14.2%	18.3%
NATIONAL BANK OF BAHRAIN BSC	Bahrain	2.6	0.625	13.5	2.1	3.6	16.8%	16.3%	9.7%	11.5%
ARAB BANKING CORP	Bahrain	1.4	0.440	6.9	0.4	6.8	13.3%	N/A	-2.3%	1.9%
BBK BSC	Bahrain	1.3	0.436	8.4	1.1	9.2	3.9%	18.9%	8.1%	7.8%
AL-SALAM BANK	Bahrain	0.5	0.085	9.4	0.6	4.0	-8.7%	1.5%	-13.9%	4.0%
ALBARAKA BANKING GROUP	Bahrain	0.4	0.330	4.2	0.4	9.1	20.6%	-4.2%	-11.0%	-8.5%
BAHRAIN ISLAMIC BANK	Bahrain	0.3	0.120	10.9	1.1	N/A	-7.7%	N/A	-6.3%	-8.1%
ITHMAAR HOLDING BSC	Bahrain	0.2	0.070	N/A	1.8	N/A	-17.6%	-18.6%	-15.7%	-10.6%
KHALEEJI COMMERCIAL BANK	Bahrain	0.2	0.061	87.9	0.6	N/A	-27.4%	1.1%	0.2%	-6.3%
NATIONAL BANK OF KUWAIT	Kuwait	19.4	0.916	15.9	1.9	3.6	19.6%	22.1%	8.1%	10.0%
KUWAIT FINANCE HOUSE	Kuwait	15.2	0.671	20.5	2.8	2.7	24.2%	25.6%	8.4%	5.8%
BOUBYAN BANK K.S.C	Kuwait	5.6	0.560	28.4	4.1	1.3	12.9%	20.0%	8.4%	12.5%
COMMERCIAL BANK OF KUWAIT	Kuwait	3.3	0.512	15.9	1.4	3.5	16.2%	19.3%	4.9%	-1.0%
GULF BANK	Kuwait	2.9	0.302	15.8	1.4	3.3	23.7%	11.4%	-1.1%	-0.6%
BURGAN BANK	Kuwait	2.8	0.326	11.0	1.1	3.5	27.0%	5.5%	-3.2%	7.2%
AHLI UNITED BANK (ALMUTAHED)	Kuwait	1.9	0.308	11.9	1.3	4.6	13.7%	-0.9%	-5.9%	5.6%
AL AHLI BANK OF KUWAIT	Kuwait	1.7	0.323	12.4	0.9	4.3	14.0%	2.5%	-2.9%	0.9%
WARBA BANK KSCP	Kuwait	1.2	0.242	38.3	1.9	N/A	15.2%	14.1%	-2.4%	N/A
KUWAIT INTERNATIONAL BANK	Kuwait	0.9	0.283	13.2	1.0	3.7	15.4%	19.2%	3.0%	8.7%
BANKMUSCAT SAOG	Oman	3.2	0.402	6.7	0.7	8.3	11.5%	12.0%	2.8%	9.2%
BANK DHOFAR SAOG	Oman	1.0	0.126	10.7	0.7	7.4	-13.5%	-9.1%	-4.7%	4.8%
NATIONAL BANK OF OMAN SAOG	Oman	0.7	0.165	6.1	0.6	9.7	-1.1%	-4.7%	1.2%	5.7%
HSBC BANK OMAN	Oman	0.6	0.120	7.4	0.7	7.8	8.4%	4.5%	0.5%	-3.3%
SOHAR INTERNATIONAL BANK	Oman	0.6	0.112	7.3	0.8	5.4	6.4%	-5.3%	-5.3%	5.5%
AHLI BANK	Oman	0.5	0.120	8.3	0.7	7.9	-7.0%	-4.2%	0.1%	8.4%
BANK NIZWA	Oman	0.3	0.088	16.4	1.0	N/A	-3.3%	5.0%	-0.2%	N/A
AL IZZ ISLAMIC BANK	Oman	0.2	0.083	38.4	1.1	N/A	-7.8%	12.0%	-3.7%	N/A
QATAR NATIONAL BANK	Qatar	49.4	195.7	13.8	2.8	3.1	3.7%	18.2%	9.7%	21.5%
QATAR ISLAMIC BANK	Qatar	11.0	170.0	15.4	2.7	2.9	15.6%	25.3%	19.8%	15.6%
MASRAF AL RAYAN	Qatar	7.4	36.2	12.7	2.2	5.5	-8.5%	7.2%	-0.7%	18.5%
COMMERCIAL BANK PQSC	Qatar	5.5	50.0	14.0	1.3	3.0	31.3%	15.0%	1.0%	9.6%
QATAR INTERNATIONAL ISLAMIC	Qatar	2.9	70.8	12.7	2.0	5.6	13.8%	10.8%	2.5%	13.2%
AL AHLI BANK	Qatar	1.9	30.0	10.4	1.3	3.0	21.9%	-2.9%	-1.4%	8.2%
DOHA BANK QSC	Qatar	1.8	21.8	11.1	0.8	4.6	3.2%	-8.3%	-12.2%	7.3%
AL KHALIJ COMMERCIAL BANK	Qatar	1.2	11.9	7.7	0.8	6.3	9.9%	-6.4%	-6.8%	5.8%
AL RAJHI BANK	Saudi Arabia	50.5	75.8	17.5	3.9	3.9	35.9%	30.2%	16.8%	12.6%
NATIONAL COMMERCIAL BANK	Saudi Arabia	49.0	61.2	17.5	3.2	3.6	30.3%	32.2%	N/A	N/A
RIYAD BANK	Saudi Arabia	23.6	29.5	16.9	2.4	2.7	51.4%	45.7%	16.9%	14.6%
SAMBA FINANCIAL GROUP	Saudi Arabia	20.4	38.3	14.1	1.8	5.2	25.1%	25.7%	14.8%	11.6%
SAUDI BRITISH BANK	Saudi Arabia	16.1	40.3	12.2	1.9	5.0	26.4%	26.1%	8.4%	6.9%
BANQUE SAUDI FRANSI	Saudi Arabia	12.8	40.0	14.4	1.6	4.0	27.2%	20.0%	9.9%	6.7%
ALINMA BANK	Saudi Arabia	11.0	27.5	15.4	1.9	3.6	24.6%	28.7%	12.2%	10.6%
ARAB NATIONAL BANK	Saudi Arabia	10.8	27.1	11.9	1.5	4.2	30.1%	31.4%	12.5%	8.4%
ALAWWAL BANK	Saudi Arabia	5.7	18.7	18.8	1.5	N/A	23.6%	12.9%	3.0%	7.1%
BANK ALBILAD	Saudi Arabia	5.2	25.8	16.5	2.3	N/A	18.3%	18.4%	4.4%	9.4%
SAUDI INVESTMENT BANK/THE	Saudi Arabia	4.0	20.1	10.0	1.3	N/A	17.2%	20.9%	2.6%	9.0%
BANK AL-JAZIRA	Saudi Arabia	3.7	16.7	12.9	1.2	3.0	20.6%	21.9%	-3.0%	7.6%
FIRST ABU DHABI BANK PJSC	UAE	49.1	16.5	15.6	2.0	4.5	23.4%	29.6%	9.7%	19.9%
EMIRATES NBD PJSC	UAE	18.0	11.9	6.7	1.2	3.4	39.5%	17.7%	8.1%	20.1%
EMIRATES ISLAMIC BANK	UAE	14.8	10.0	48.0	7.1	N/A	0.1%	93.9%	N/A	N/A
ABU DHABI COMMERCIAL BANK	UAE	14.3	10.1	11.2	1.8	4.6	29.5%	21.7%	11.0%	25.4%
DUBAI ISLAMIC BANK	UAE	9.5	5.3	7.3	1.5	6.6	13.2%	11.5%	6.7%	17.6%
ABU DHABI ISLAMIC BANK	UAE	4.8	4.8	8.1	1.4	5.7	31.7%	15.8%	1.0%	16.2%
UNION NATIONAL BANK/ABU DHAB	UAE	4.4	5.9	17.9	1.0	3.4	31.1%	23.9%	1.6%	17.0%
MASHREQBANK	UAE	3.7	76.0	6.5	0.7	5.3	2.3%	2.7%	-2.9%	-0.7%
COMMERCIAL BANK OF DUBAI	UAE	3.0	4.0	9.2	1.2	5.2	4.7%	-7.0%	0.0%	12.2%
NATIONAL BANK OF FUJAIRAH	UAE	2.4	4.8	15.2	1.9	1.5	13.8%	11.4%	12.6%	N/A
INVEST BANK	UAE	2.2	2.5	N/A	1.6	N/A	0.0%	6.0%	0.3%	16.6%
NATIONAL BANK OF RAS AL-KHAI	UAE	2.0	4.4	7.6	1.1	6.9	11.1%	0.0%	-5.6%	15.8%
NATIONAL BANK OF UMM AL QAIW	UAE	1.2	2.3	10.6	1.0	4.7	-18.0%	-7.7%	-1.3%	1.5%
SHARJAH ISLAMIC BANK	UAE	0.9	1.2	6.4	0.6	7.0	7.1%	-0.2%	-3.9%	10.1%
UNITED ARAB BANK PJSC	UAE	0.7	1.2	31.8	1.0	N/A	-0.8%	-19.0%	-24.6%	N/A
BANK OF SHARJAH	UAE	0.5	0.9	5.5	0.5	N/A	-9.2%	-9.6%	-12.6%	1.9%
AJMAN BANK PJSC	UAE	0.5	0.9	9.3	0.8	3.9	3.9%	-17.9%	-18.0%	1.8%
COMMERCIAL BANK INTERNATIONA	UAE	0.3	0.6	4.8	0.5	N/A	-29.8%	-32.8%	-22.5%	-5.8%
AMLAK FINANCE	UAE	0.1	0.3	N/A	0.4	N/A	-4.9%	-39.3%	N/A	N/A

Source : Bloomberg

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- ***Underperform:** Target Price represents an expected return of <-10% in the next 12 months*

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KAMCO Investment Company

Al-Shaheed Tower, Khalid Bin Al-Waleed Street- Sharq

P.O. BOX : 28873, Safat 13149, State of Kuwait

Tel: (+965) 1852626   Fax: (+965) 22492395

Email : Kamcoird@kamconline.com

Website : http://www.kamconline.com