Gulf Investment Corporation

Annual Report and Accounts 06

Mission Statement

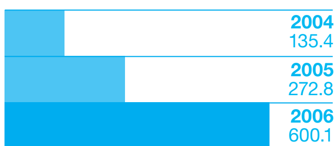
Gulf Investment Corporation (GIC) is a leading financial instituition offering a comprehensive range of financial services to promote private enterprise and support economic growth in the Gulf Cooperation Council (GCC) region.

To become a 'world-class' organisation, GIC is dedicated to realising its clients objectives, to maximizing shareholder value through earning competitive rates of return, and to the professional development of its people.

Key figures

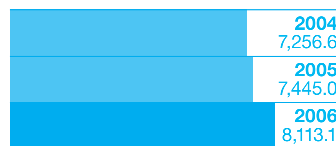
120%

Net Income
US$ million



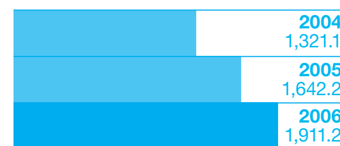
9%

Total Assets
US$ million



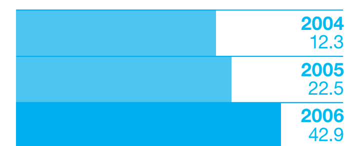
16%

Shareholder's Equity
US$ million



91%

Return on Shareholder's Equity
%



Financial Highlights

(US$ million)	2004	2005	**2006**
For the year			
Gross Operating and Other Income	178.5	329.7	**661.8**
Operating Expenses	36.5	45.5	**56.2**
Net Income	135.4	272.8	**600.1**
At year end			
Total Assets	7,256.6	7,445.0	**8,113.1**
Interest Bearing Securities and Funds	4,849.0	4,460.8	**4,746.3**
Equities and Managed Funds	549.1	1,180.3	**1,153.7**
Projects and Equity Participations	435.2	736.2	**1,076.9**
Deposits	2,357.3	2,061.1	**2,131.4**
Shareholder's Equity	1,321.1	1,642.2	**1,911.2**
Selected Ratios (%)			
Profitability			
Return on Paid-up Capital	18.1	36.4	**80.0**
Return on Adjusted Shareholders' Equity	12.3	22.5	**42.9**
Capital			
BIS Ratios			
– Total	24.0	25.6	**21.7**
– Tier 1	22.2	22.9	**20.6**
Shareholders' Equity as a % of Total Assets	18.2	22.1	**23.6**
Asset Quality			
Marketable Securites as a % of Total Assets	64.3	55.9	**53.2**
GCC and OECD Country Risk as a % of Total Assets	99.2	99.4	**98.3**
Liquidity			
Liquid Assets Ratio	81.2	78.6	**80.4**
Productivity			
Operating Income as Multiple of Operating Expenses	4.9	7.2	**9.8**

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Board of Directors

State of Kuwait
H.E. Dr. Yousef Hamad Al-Ebraheem*
Chairman
Advisor to H.H. The Emir of Kuwait

H.E. Mr. Saleh Mohammed Al Yousef§

United Arab Emirates
H.E. Mr. Faisal Ali Al Mansouri**
Manager of Investment Department
Ministry of Finance & Industry

H.E. Mr. Saeed Rashid Al Yateem§
Director of Budget Department
Ministry of Finance & Industry

Kingdom of Bahrain
H.E. Dr. Zakaria Ahmed Hejres*
Deputy Chief Executive
Economic Development Board

H.E. Mr. Khalid A. Al-Bassam§§
Chairman
Bahrain Islamic Bank

Kingdom of Saudi Arabia
H.E. Dr. Yahya Bin Abdullah Al-Yahya*
Economic Consultant
Saudi Arabian Monetary Agency

H.E Mr. Mohammed S. Dobaib§
Acting Director General
Saudi Industrial Development Fund

Sultanate of Oman
H.E. Mr. Darwish bin Ismail bin Ali Al-Bulushi*
Secretary General
Ministry of Finance

H.E. Mr. Abdul Kader Askalan§
Chief Executive Officer
Oman Arab Bank

State of Qatar
H.E. Shaikh Fahad bin Faisal Al-Thani*
Deputy Governor, Qatar Central Bank

H.E. Dr. Hussain Ali Al-Abdulla§
Board Member – Executive
Qatar Investment Authority

Senior management
Mr. Hisham Abdulrazzaq Al-Razzuqi
Chief Executive Officer & General Manager

Mr. Rashid Bin Rasheed
Deputy General Manager &
Head of Finance & Administration

** Chairman of the Executive committee
* Member of the Executive Committee
§§ Chairman of the Audit Committee
§ Member of the Audit Committee

Business Highlights

120% increase in net profit to a record US$ 600.1 million, the sixth consecutive year of earnings growth and the second in record earnings.

Strong growth in Principal Investments with gross operating income up 155% year-on-year.

Major project wins in key sectors of chemicals, metals, power, financial services and telecommunications.

Innovation in Global Markets offerings to clients with new products that match the best in world markets, supported by strong returns profile.

Chairman's Statement

On behalf of the Board of Directors, I have the privilege to present the annual report and accounts of Gulf Investment Corporation for the year 2006.

For the sixth consecutive year, GIC reported a new record net profit up 120% during 2006 to US$ 600.1 million, driven primarily by a 155% surge in income from principal investments in projects, the Corporation's core business. This net profit represents a return on adjusted average equity of 42.9% and a return on paid-up capital of 80%, compared to 22.5% and 36.4% respectively for the previous year. Balance sheet total assets grew at a rate of 9% and reached US$ 8,113.1 million. At year end, shareholders' equity increased to US$ 1,911.2 million from US$ 1,642.2 million at the previous year end, reporting a year-on-year increase of 16.4%

It is worth mentioning that this is the highest achieved profits, surpassing the record profits earned in 2005 by more than double. The corporation continues to reap the benefits of the strategic policy adopted in early 2001, focusing on the diversification of both investments and revenue resources, enhancing revenue sustainability, increasing efficiency through managing expenses, and phased expansion of operating business lines. The performance and results achieved since then stand testimony to the success of this strategic revitalization.

GIC's commitment to remain focused on the GCC region is indicated by the growth rate in the projects, which has increased during the year by 46% to report US$ 1,077 million. Over the previous years, building on our knowledge and understanding of the regional business environment, and our strong networking capabilities, GIC has played a vital role in promoting private enterprises and contributed to the development of the GCC economies through participating in major projects in the fields of infrastructure, power and utilities, metal, and petrochemicals. The returns from principal investments in projects were

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generous, reflecting the strong growth in the GCC economies and the progress in the life cycle and improved operating efficiencies of the projects portfolio.

With the objective of achieving adequate diversification, and within the approved investment limits, GIC's exposure to the GCC region is balanced by investments in the global markets spread across a different array of asset classes and investment strategies, which showed good performance and contributed to the Corporation's profit.

The Corporation's strong and consistent performance, its robust risk management skills and solid capital position is reflected in its credit ratings by the major international rating agencies. Moody's and Standards & Poor's maintained their rating at A2 and A- respectively, while Fitch issued its first report rating the Corporation at A. Those ratings will not only positively impact our funding cost, but also they will further enhance GIC's standing as a high quality business partner. We see such ratings as an external validation of our business model and we will strive towards achieving further upgrades.

With its solid capital position, excellent human resources, and strong track record, GIC has established itself as a regional leader in its chosen fields of business and is well positioned to take advantage of the opportunities in its operating environment.

I took over as Chairman of the Board of Directors on February 16, 2006. On behalf of the Board of Directors, I wish to take this opportunity to express my gratitude to my predecessor, H.E. Sheikh Fahad Bin Faisal Al-Thani, Deputy Governor of Qatar Central Bank. I would also like to express my appreciation to H.E Mr. Shabib Ahmed Bin Rashid Bin Shabib, and H.E. Mr. Ibrahim M. Al-Romaih for their valuable contribution as members of GIC Board of Directors. I also wish to thank the management and staff at GIC for their commitment and efforts rendered during the year in achieving the Corporation's goals.

Dr. Yousef Hamad Al-Ebraheem
Chairman

CEO's Review

2006 was another successful year for GIC, with net profits reaching a record US$ 600.1 million, the highest ever in the Corporation's history, and more than double that achieved in 2005.

The 120% year-on-year increase in net profits enhanced return on average equity to approximately 42.9% for 2006, up from the 22.5% achieved in the previous year. This surge in earnings was driven by growth in revenues across all key businesses.

This is the sixth consecutive year of earnings growth since 2001, when GIC initiated a strategic reorientation aimed at diversifying revenues and leveraging its core strengths. Profitability grew by a multiple of seven times during this period, with return on adjusted shareholders' equity increasing to 42.9% in 2006 from 7.3% in 2001. GIC will continue to maintain and enhance the flexibility and adaptability that enabled us to perform well during difficult and changing business environments.

The US$ 600.1 million net profit includes a non-operating component of US$ 111.4 million, pertaining to realization of written off loans made to the Republic of Iraq prior to 1990, through its then subsidiary Gulf International Bank (GIB). The balance of US$ 488.7 million income from operations still reflects a year-on-year growth of approximately 80%.

Principal Investments
The principal investments activity continued to be the prime driver of corporate profitability, contributing approximately 45% of overall profits. 2006 was an excellent year for this activity, with gross operating income growing by more than 150% year-on-year, and several new initiatives being successfully executed. Strategic investments within the Steel and Chemicals sectors provided handsome returns, boosted by the strong economic growth in the GCC region. The corporation's revitalized strategy, focusing on certain core themes and sectors within these project activities has proved to be beneficial, with several of these investments yielding excellent returns. The underlying philosophy within our principal investment activity has always been the same: detailed fundamental analysis, strict financial discipline and adequate post-investment monitoring. Over the years, the Corporation has built up a high quality portfolio of projects covering the GCC region, well diversified across several sectors and industries.

GIC has established a sound franchise and emerged as a prominent player in the region, winning major projects within key sectors including Power, Chemicals, Metals, Telecommunication and Financial Services. During 2006, several new initiatives were executed, including taking a 9.3% share in Perella Weinberg partnership, a new financial services firm providing independent strategic advice to large global corporate clients as well as managing various alternative investment vehicles.

Within the power sector, a GIC consortium successfully competed with major international players to win the Marafiq Water & Power project in Saudi Arabia. This project, with a projected outlay of US$ 3.4 billion, is expected to have a generating capacity of 2,750 MW, while supplying a significant quantity of fresh water to the nation. During 2006, GIC in association with ACWA Power and Mitsubishi Corporation, was also successful in winning the Al Shuqaiq project, a similar mandate within the power sector in Saudi Arabia.

Within the metals sector, GIC made significant moves in consolidating its interests and aligning itself with strategic regional partners. In mid 2006, the Corporation acquired the remaining 50% share held by Brazil's Companhania Vale Rio Doce (CVRD), its joint venture partner, in Gulf Industrial Investment Company (GIIC). This GIIC investment along with GIC's other existing and proposed new investments in the steel sector are being grouped within a holding company in which GIC would have a controlling share, whilst bringing together major players with similar strategic interests in the region. This holding company will form the first fully integrated steel company in the region, from iron ore to finished product, catering to the growing demand for steel products which is a fundamental requirement for the continued economic growth of the GCC.

CEO's Review continued

2006 was an excellent year for GIC in several aspects and is primarily the result of dedicated efforts from a team of committed professionals. I wish to congratulate the staff of GIC for this commendable performance.

The corporation continued to expand its interests in the Chemical sector of the region, participating in the restructuring of National Petrochemical Industrialization Company (NPIC) and National Industrialization Company (NIC). GIC now has a 7% shareholding in the publicly listed NIC.

GIC is also playing a key role in developing other important sectors like construction materials, health care and education.

It is our aim to continue playing a leading role as a promoter of investment ideas and themes that enhance and encourage private enterprise within the GCC economies, while providing adequate financial returns to the Corporation and our partners.

Global Markets

Global Markets activities include investments in both regional and international markets covering a range of strategies for both proprietary and third party asset management. Proprietary assets are managed by both internal and externally selected professionals. Our diversified portfolio of proprietary assets include debt securities, public and private equities, alternative and hedge strategy funds, Islamic transactions, structured products and derivative transactions.

Contributions from GIC's proprietary investments in alternative and hedge fund strategies more than doubled compared to the previous year, resulting from a prudent expansion in these themes. The timely scaling down of equity exposures in the regional stock markets limited the adverse impact of a downturn in these markets during 2006. Enhanced returns from the portfolio of international private equity funds, coupled with improved revenues from fee based activities, contributed positively to overall earnings as well.

During 2006, a new Structured Products team was set up to focus on proprietary and client investments in structured finance products. Such products with superior risk-return characteristics are expected to compensate the declining spread income from the conventional debt portfolios. With the establishment of this new division, the Corporation also aims to deliver a range of new products to regional investors.

Another significant achievement during the year was the launching of Istimlak, a GCC real estate product. Following the international approach of the Real Estate Investment Trusts (REIT), Istimlak will focus on ownership of income-generating, fully operational real estate assets in the GCC region, with plans of going public through an IPO once the necessary regulatory approvals have been met. The IPO is aimed at bringing the first REIT-like product to the region, enabling local investors to participate in the regional expansion of this sector, while providing regular equity dividends.

GIC has always recognized that sound risk management is vital to long term growth and stability, and in this regard has committed significant resources to strengthen its risk management activities. The corporation has and will continue

bring its risk management capabilities in line with international best practices. GIC is among the select few regional financial institutions to fully implement the Basel II framework, including the guidelines pertaining to comprehensive disclosure.

The corporation's funding profile and liability structure was further enhanced in 2006 with the successful issuance of the Euro 400 million floating rate notes, as a part of its EMTN program. This five year medium term note was the largest ever Euro denominated transaction within the GCC, attesting to GIC's premier position in the regional and international markets.

Reaffirming GIC's premier position in the region, Fitch Ratings assigned a long term IDR of A and a short term rating of F1, with a stable outlook for both. The Fitch report highlighted the Corporation's strong capitalization, consistent profitability, cost efficiency and good franchise in GCC private equity investments as key strengths. GIC continues to be rated A- by Standard & Poor's and A2 by Moody's. GIC is among a select few financial institutions in the region to maintain such high ratings by all three major international agencies.

The superior ratings reflect, among other strengths, the Corporation's strong track record, ownership, consistent and clear strategy, and effective management.

During 2006, GIC initiated an expansion strategy that will result in creating local presence in various GCC markets. Such expansion will enhance GIC franchise and provide a strong basis for business growth.

2006 was an excellent year for GIC in several aspects and is primarily the result of dedicated efforts from a team of committed professionals. I wish to congratulate the staff of GIC for this commendable performance. I would also like to take this opportunity to thank the Board of Directors for their guidance and support. Going forward, I am confident that the strong foundation we have set in place will enable us to achieve our objectives and goals to the benefit of our shareholders and the region we serve.

Mr. Hisham Abdulrazzaq Al-Razzuqi
CEO and General Manager

GIC is practically assisting in meeting the GCC region's growing demand for water and electricity. Al-Ezzel project in Bahrain and the new Marafiq and Shuqaiq independent water and power projects in Saudi Arabia are examples of GIC's expanding regional role.

Economic Review

Strong oil prices and revenues spawned another bumper year of growth in the GCC region. The world economic cycle, although slowing in the US, the largest economy, continued strongly in Europe and Japan. The Asian economies, particularly China and India, witnessed a high-paced growth equal if not exceeding that of the previous year.

The World Economy and Markets

After four years of strong growth averaging above 4%, the world economy started a slight shift in gear in the second half of the year, evidenced in US GDP growth slowing from a rate of 5.6% in 1Q 2006 to 2% in 3Q 2006 and 2.2% in 4Q[1]. Because the US represents, in nominal terms, about 29% of the world GDP, and because it has strong trade links with major economies, especially China, Canada and to a lesser extent the EU, the slowing in the US GDP is bound to have an impact on the rest of the world. Overall, US growth in 2006 is still forecast in the range of 3.4% (IMF) or 3.3% (Consensus Forecasts). Growth in Japan has actually picked up during the first three quarters of 2006, but signs of a slowing down, especially in consumer spending, became apparent in the last months of the year. Europe, though, was a surprise. The Eurozone, especially, Germany and France, performed better in 2006 than in 2005, with growth picking up later in the year and finishing at 2.0%-2.7% compared with 1.4% in 2005. This divergence between US and Europe has been particularly apparent in the monetary policy arena. The US Federal Reserve raised rates for the last time in June 2006, but the ECB was in a tightening mode till year-end, with the refinancing rate increasing to 3.5% in December 2006. Emerging Markets have shown strong growth in 2006, particularly China and India with actual growth consistently exceeding consensus forecasts of economists. With a growth rate of 10.2% in 2005, China's growth in 2006 is estimated at 10.7%. India has also continued on a strong growth path during 2005-2006 averaging 8.7%.

This strong economic picture was mirrored favorably in the world financial markets. The equity markets in developed economies, particularly in Europe and the US, had double digit returns during the year. The best performing was the German market where DAX (Xetra) gained 22% in local currency terms and 35% in US dollar terms. French equities returned 18% in Euro and the UK 11% in Sterling (23% in US dollar terms).

The US major indices returned 16% (DJIA), 14% (S&P 500) and 10% (NASDAQ Composite). The Japanese market was the least attractive to equity investors with the Nikkei 225 gaining 7% in the year.

The US equity markets benefited from high corporate earnings and also the general optimism, later in the year, that the Federal Reserve was finished with the rate hiking cycle. Weaker economic data coming out of the housing market and a more benign result in the inflation gauge most favored by the Federal Reserve (Personal Consumption Expenditure – PCE) which was 2.2% at the end of November, conjured an end to interest rate hikes.

The equity markets in Europe were up because growth was higher than expected (and also than the previous year) supported by corporate restructuring, especially in Germany and a boom in M&A activities where the dollar value of all M&A activities in Europe in 2006 (at $1,530 bn) exceeded those in the US (at $1,440 bn).

1 Official estimates

Table I: GDP Growth for Major World Economies, Actual and Estimate 2005-2006 (% change)

	Actual	Estimate	
	2005	2006	
		Consensus Forecast	IMF
United States	3.2	3.1	3.4
Japan	1.9	2.2	2.7
Germany	0.9	2.7	2.0
United Kingdom	1.9	2.7	2.7
France	1.2	2.0	2.4
Italy	0.1	1.9	1.5
Canada	2.9	2.7	3.1
Eurozone	1.4	2.8	2.4
China	10.2	10.7	10.0
India	8.5	9.0	8.3

Source: Consensus Economics Inc, Consensus Forecasts Survey, March 12 2007 and IMF, World Economic Outlook, September 2006.

Table II: Global Equity Indices for 2006 (in local currencies)

Index	30 Dec 05	29 Dec 06	High 2006		Low 2006	
North America						
DJIA	10,717.50	12,463.15	12,510.57	27 Dec	10,667.39	20 Jan
S&P 500	1,248.29	1,418.30	1,427.09	15 Dec	1,223.69	13 Jun
NASDAQ Composite	2,205.32	2,415.29	2,465.98	22 Nov	2,020.39	21 Jul
Russell 2000	673.22	787.66	797.73	27 Dec	671.94	21 Jul
DJ Wilshire 5000	44.17	51.14	51.46	27 Dec	43.70	13 Jun
DJ Wilshire Global Total Market	2,375.41	2,830.97	2,835.21	28 Dec	2,346.27	13 Jun
Europe						
FTSE 100	5,618.80	6,220.80	6,260.00	15 Dec	5,506.80	14 Jun
Xetra Dax	5,408.26	6,596.92	6,611.81	28 Dec	5,292.14	13 Jun
CAC 40	4,715.23	5,541.76	5,541.76	29 Dec	4,615.44	14 Jun
Asia						
Nikkei 225	16,111.43	17,225.83	17,563.37	7 Apr	14,218.60	13 Jun
Hang Seng	14,876.43	19,964.72	20,001.92	28 Dec	14,944.77	3 Jan

Source: Bloomberg.

The Japanese equities, after a spectacular year in 2005 (growing by 40%), had a lackluster year, especially with Bank of Japan starting in July 2006 a cycle of tightening.

The bond markets show a different picture. Merrill Lynch Global Corporate Bond Market Index returned 2.64% in 2006 but Merrill's High Yield Index showed a gain of 11.68% (Table IV). The US 10-year Treasuries did not fare better than Corporate bonds with total returns for the year at 1.8% (compared to 6.2% in 2005).

The yield on 10-year US Treasuries did not move much between December 2005 (at 4.29%) and December 2006 (4.62%). What Chairman Greenspan (who retired from the US Federal Reserve in January 2006) called the bond conundrum, continued in 2006. The US Treasuries are still the preferred instrument for surplus central banks and public authorities in countries with large current account surpluses (China, Japan and the OPEC producers, especially those in the GCC region). As a result, the 10-year US Treasury yield which has been expected to exceed 5% in 2006, has actually witnessed only a brief period of yields in the range of 5% during 2006 (between mid-April and July).

Investors in the commodities market have had another year of double digit returns (Table VII) supported by strong metals prices and also other commodities such as oil, indicating that the upward cycle of the world economy still had steam in it.

The currency markets saw the US dollar exchange values versus two major currencies (euro and UK pound) go down noticeably: by 11.3% against the euro and 13.9% against the pound sterling. The yen, which has been expected to appreciate against the US dollar has actually slightly declined in value.

The US current account deficit which stood at US$ 792 billion at the end of 2005 (representing 6.3% of GDP), continued to increase in absolute terms, if not as a percentage of GDP. It is estimated to reach US$ 850 billion by year end 2006.

The Oil Markets

The oil markets witnessed another year of strong prices. Indeed, oil prices peaked in nominal terms during July when WTI reached 77.03% on 14 July 2006. As Table IX indicates, oil prices started an upward trend in 2002. The major jumps happened during 2004 (28.3%) and 2005 (40.5%). The average increase in oil prices in 2006 is expected to be in the range of 20%. Aside from geopolitical risks and supply disruptions which are actually unavoidable due to accidents, weather or sometimes sabotage, there are other fundamental reasons for the strong oil prices: Demand is increasing annually in the range of 1.2-1.5 m b/d. The spare production capacity in oil producing countries has been utilized and what is left is in the range of 1.2-1.5 million barrels, mainly in Saudi Arabia and some other GCC producers (Figure I). Moreover, OPEC has shown a resolve to defend oil prices in the range of $50-$60 per barrel. This happened when prices in October and November dropped by about 25% off their peak in July. In Doha (19 October 2006) OPEC decided on 1.2 m b/d cut in its production effective first of November. When OPEC Secretariat proposed that inventory levels of crude and products in developed markets have become noticeably higher than the average of the last few years, OPEC once again in Abuja (Nigeria) on 14 December decided on a further production cut of 500,000 barrels a day effective 1 February 2007, fearing that high inventories will lead to a spiral drop in oil prices when demand softens in the beginning of Q2 2007.

This oil market picture led most analysts to believe that a $50-$60 price of oil is going to stay for at least the next two years. As Table X shows, some still forecast higher oil prices in the years 2007-2009, mainly because of lack of trust in the ability of Non-OPEC producers to increase their production by the planned 1.3-1.7 mb/d in 2007-2008. There is also the issue of declining production from present oil fields in most countries at a rate not anticipated a few years ago.

What is important to highlight here is the ability of the GCC economies to continue on a path of sustained economic growth supported by strong oil prices. As Table XI shows, estimates of the annual oil revenues for the six GCC countries in 2006-2007 is around US$ 400 billion.

The GCC Economies: Sound Macroeconomic Fundamentals

While the global economy is estimated to grow by around 4.5% during 2006, factors such as higher international oil prices, sound macroeconomic policies, and on-going structural reforms have strengthened the economic fundamentals of the GCC countries. The growth in nominal GDP reflects the circumstances of each country, with Qatar the highest followed by UAE, Kuwait, Bahrain, Oman and Saudi Arabia.

Table III: World Equity Markets Capitalization compared with World Economy Share (by Major Markets) (Year-end)

	World Market Capitalization 2006			Gross Domestic Product 2005	
	30/12/06	% change	% of World	GDP (Bn US$)	% of World
World	**49,979,092**	**22.14**	**100.00**	**42,389**	**100.00**
United States	17,467,300	11.20	34.95	12,486	29.46
Japan	4,872,675	-1.56	9.75	4,571	10.78
United Kingdom	3,808,096	24.72	7.62	2,201	5.19
France	2,510,735	34.92	5.02	2,106	4.97
Hong Kong	2,132,140	84.85	4.27	178	0.42
Germany	1,757,780	36.72	3.52	2,797	6.60
Canada	1,505,920	18.20	3.01	1,130	2.67
Switzerland	1,202,170	50.81	2.41	368	0.87
Italy	1,018,622	25.42	2.04	1,766	4.17
Russia	1,030,267	89.17	2.06	766	1.81
Australia	928,968	31.59	1.86	708	1.67
China	950,225	199.84	1.90	2,225	5.25
India	816,476	49.50	1.63	775	1.83
Brazil	708,397	54.13	1.42	793	1.87
Saudi Arabia	322,754	-50.92	0.65	307	0.72
Rest of the World	8,946,567	31.66	17.90	9,212	21.73

Source: Bloomberg.

Table IV: Merrill Lynch Global Bond Market Returns (Year-end)

	2006	2005	2004
Corporate Index	2.64%	3.19%	5.76%
High Yield Index	11.68%	3.15%	11.42%

Source: Bloomberg.

Table V: US Treasury Bill 10+ Yrs Total Returns (Year-end)

	2006	2005	2004
Bloomberg	1.8%	6.2%	7.6%
MSCI	2.0%	6.5%	7.7%

Source: Bloomberg.

Economic Review
continued

Table VI: US Treasuries (Yields) (%)

	29 December 2006	30 December 2005
3 months	5.01	4.08
6 months	5.09	4.38
2 year	4.81	4.40
5 year	4.69	4.35
10 year	4.70	4.39
30 year	4.81	4.54

Source: Bloomberg.

Table VII: Bloomberg Global Commodity Index (Y/Y % change)

2006	2005	2004
16.46%	18.1%	6.6%

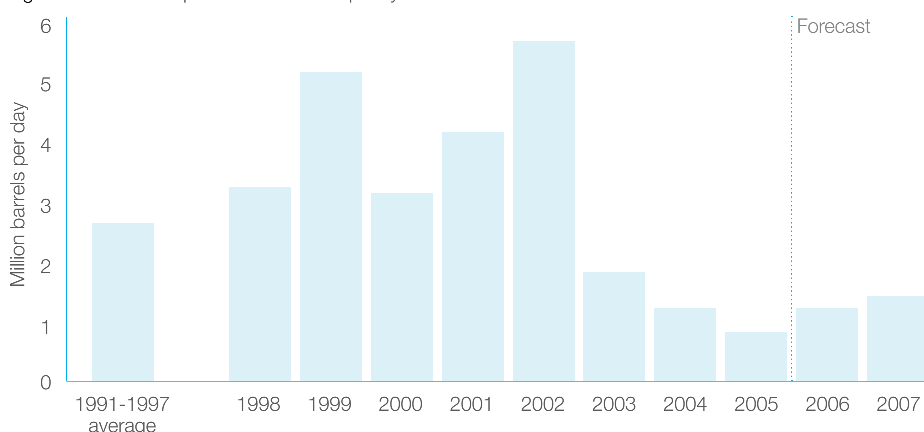
Source: Bloomberg.

Table VIII: FX Rates (Year-end)

	29 December 2006	30 December 2005
Euro	$1.3170	$1.1830
Pound	$1.9619	$1.7232
Yen	119.07 per dollar	117.75 per dollar

Source: Bloomberg.

Figure 1: World Oil Spare Production Capacity



Source: According to EIA, Short-Term Energy Outlook, November 2006 "Surplus world crude oil production capacity, all of which is located in Saudi Arabia, is projected to increase only slightly in 2007".

Table IX: Spot Crude Prices – Yearly Average (US$/bl)

	OPEC Basket		Brent		WTI	
High 2006	72.64 on 8 Aug		78.63 on 7 Aug		77.03 on 14 Jul	
Low 2006	53.37 on 31 Oct		55.77 on 2 Nov		55.81 on 17 Nov	
	Avg. Price	Y/Y % change	Avg. Price	Y/Y % change	Avg. Price	Y/Y % change
Year 2006	61.08	20.6%	65.16	19.7%	66.04	16.9%
Year 2005	50.64	40.5%	54.44	42.4%	56.51	36.4%
Year 2004	36.05	28.3%	38.23	32.7%	41.44	33.3%
Year 2003	28.10	15.4%	28.81	15.1%	31.09	19.0%
Year 2002	24.36	5.4%	25.03	2.3%	26.13	0.5%

Notes: OPEC price averages is usually lower than Brent.
Source: MEES, 22 January 2007 and various issues and Bloomberg

Table X: Crude Oil Price Outlook – Yearly Average (US$/bl)

Sources	2007	2008	2009
	WTI		
EIA	65.17		
CGES	66.12	66.71	65.70
Consensus Economics	62.10	59.50	58.90
Barclays Capital	76.00	67.30	70.80
Credit Suisse	54.50	49.50	46.00
PIW	66.45		
	Brent		
EIU	55.25	48.00	42.00
Barclays Capital	74.80	66.20	69.10
Credit Suisse	52.50	47.50	44.00
IIF	70.00		

Table XI: GCC Oil Revenues (Nominal US$ Billion)

	Actual	Forecast	
	2005	2006	2007
Bahrain	7.8	9.8	10.0
Kuwait	44.0	56.6	59.4
Oman	15.7	19.9	20.7
Qatar	22.9	29.3	31.5
Saudi Arabia	162.4	202.0	210.0
United Arab Emirates	55.1	73.3	80.5
GCC	307.9	390.9	412.1

Source: Energy Information Administration, OPEC Revenues Fact Sheet 2006, and Institute of International Finance, Inc, August 2006.

Economic Review continued

Having relatively flexible labor markets and fairly open trade systems helped the GCC countries to maintain moderate rates of inflation during the last two years. Qatar and the UAE, however, are – for different reasons – on the high-end of the inflation spectrum (see Table XII). In 2006 inflation rates were estimated to increase in many GCC countries, due to the high volumes of liquidity and the relatively limited scope of absorptive capacity (ie, no slack in any sector). Qatar will continue to have the highest growth rate in nominal and real terms during 2006 and beyond. The UAE, with the most diversified economic structure in the region, will enjoy also a high growth rate in real terms. Saudi Arabia's real GDP growth at 5.7% and Kuwait at 4.3% will be on the lower end of the scale.

GCC countries managed to attract more than $20.5bn of FDI inflows in 2005, and the upward trend continued in 2006 with heightened interest of foreign investors in the opportunities offered by regional oil and gas, power and infrastructure projects.

Trade surplus for GCC countries is estimated to grow by 30% to reach $302.5bn in 2006 compared to $232.4bn in 2005, thus current account surplus is estimated to increase markedly by 35.8% to reach $227.3bn in 2006 compared to $167.4bn in 2005.

The GCC countries continued to maintain positive fiscal and trade balances. Fiscal balance as percentage of GDP is estimated to increase from 21.7% in 2005 to 23.7% in 2006. Saudi Arabia has been using its huge oil revenues to reduce public debt which dropped as a percentage of GDP from 28% in 2005 to 17% in 2006.

With respect to their financial markets development, GCC countries have higher ratio of financial deepening as measured by M2 to GDP as well as stock market capitalization to GDP compared with average emerging markets. The extent of financial intermediation, proxied by domestic private sector credit as percentage of GDP, is comfortably high for GCC countries, with UAE the highest at more than 70%, followed by Kuwait at 61%, Qatar 56%, Bahrain at 53%, Saudi Arabia at 39%, then Oman. The key driver of credit growth in the GCC region is consumer loans.

Sector Development

GCC countries have utilized a large part of their oil revenues in several mega projects such as oil and natural gas; ports; power and desalination projects. Moreover and particularly in Dubai, Qatar, and Bahrain, large real estate projects are underway.

Public Utilities, Infrastructure and Construction

Private sector participation in this sector is increasing markedly with more projects being undertaken on BOOT, BOO, or BOT bases or through private-public partnership. In early 2006, Bahrain completed its largest privatization by selling its project, the Al-Hidd power and water plant for $738mn, through BOO.

Formal procedures have been taken in Saudi Arabia to establish a national water company to undertake the privatization of the water and sewerage sector, which is expected to take place during 2007.

Saudi Arabia's Water and Electricity Company (WEC) initiated three independent water and power projects (IWPPs), Shuqaiq, Shu'aiba and Ras Azur. The government has signed a SR12.6bn contract to establish a giant dual purpose IWPP in Jubail on BOT basis. UAE is undertaking the seventh IWPP by Abu Dhabi Water and Electric Authority (ADWEA) at Fujairah. The Abu Dhabi Future Energy Company launched the $250mn Masdar Clean Tech Fund in partnership with Credit Suisse and UK-based Consensus Business Group (CBG). The fund will invest in companies promising clean energy technologies.

During the year an announcement was made that Emaar Economic City (EEC) – a partnership between the UAE's Emaar Properties and Saudi investors – is building the King Abdullah Economic City at an estimated cost of SR100bn ($26.6bn), the largest private investment in Saudi Arabia.

Oil and Gas, Aluminum, Petrochemicals and Other Sectors

Saudi Arabia has discovered four significant gas fields during the year. Plans were announced for an oil refinery in Jizan Economic City (JEC) that is expected to attract more than $26.7bn in investment, making it the Kingdom's sixth refinery. With this refinery completed, refining capacity is expected to increase from 1.9 mb/d in 2006 to 3 mb/d in 2010. JEC's industrial zone will accommodate next to the oil refinery, a port, an aluminum smelter and two processing plants for steel and copper. Saudi Basic Industries Corporation (SABIC) has signed an agreement to acquire 100% of Huntsman's, a UK Base Chemicals and Polymers business, for a purchase price of $700mn. In Oman Sohar refinery with 116,400 b/d capacity has been commissioned in late 2006.

Table XII: GCC Nominal GDP and Real GDP Growth (Actual and Estimates)

	2005				2006*		
	Nominal US$ bn	IMF	IIF	EIU	IMF	IIF	EIU
Bahrain	13.2	6.9	6.6	5.9	7.1	9.0	6.1
Kuwait	80.8	8.5	5.9	8.3	6.2	4.3	8.0
Oman	30.7	6.7	4.8	5.6	7.1	8.2	6.5
Qatar	42.1	6.5	11.1	8.8	6.7	12.1	7.9
Saudi Arabia	309.9	6.6	6.6	6.6	5.8	5.7	5.4
United Arab Emirates	132.2	8.5	8.2	8.2	11.5	7.7	10.2

* Estimates
Sources: International Monetry Fund, World Economic Outlook, September 2006. IIF, Country Reports, August 2006. EIU, Country Forecasts, October 2006.

Table XIII: GCC Inflation Rates (CPI) (Y/Y % Change)

	2002	2003	2004	2005	2006[E]
Bahrain	-0.5	1.6	2.4	5.0	4.4
Kuwait	1.4	1.0	1.1	4.1	3.6
Oman	-0.2	-0.6	0.4	1.3	4.0
Qatar	0.2	2.3	6.8	8.8	9.2
Saudi Arabia	0.2	0.6	0.5	0.5	1.6
United Arab Emirates	2.9	3.1	5.0	6.2	8.5
GCC Countries*	0.9	1.2	1.9	4.3	5.2

[E] IIF Estimates
* Weighted average
Source: IIF, GCC Regional Report, August 2006.

Table XIV: GCC Trade and Current Account Balance (US$ Bn)

	2002	2003	2004	2005	2006*
Trade Balance	78.8	108.6	152.2	232.4	302.5
Current Account	25.2	52.5	89.2	167.4	227.3

* Estimates
Source: IIF, GCC Regional Report, August 2006.

Economic Review continued

The number of GCC aluminum smelters in the region has reached seven. Currently the only GCC producers are Alba in Bahrain and Dubal in UAE. The other five are under way in Oman, Qatar, UAE, and KSA. Production capacity, estimated at 1.6m tonnes in 2006, should grow during 2006-2009 by 63.7% to reach 2.6m tonnes.

In the UAE, Sharjah-based Dana Gas agreed to acquire Canada's Centurion Energy for $950m, which reflects the strong appetite for acquisition among a new class of privately-held energy companies that has emerged in the Gulf over the last two years.[1]

Manufacturing

The Abu Dhabi government, early in 2006, announced plans to develop a new port and industrial area at Taweelah, with total cost in excess of Dhs 8bn ($2.1bn).

During the year, Kuwait Finance House (KFH) launched a $1bn Science and Technology Park in Bahrain, the first in the region hosting small, medium, and large technology companies. Also, later in the year, Japan Bank for International Cooperation (JBIC) granted Oman a $150m loan to finance part of the second phase for Sohar Industrial Port.

Saudi Aramco set up a new overseas company office in Shanghai to identify and assess manufacturer capability and performance focusing on material supply services and inspection benchmarked to Saudi Aramco's commodities requirements. A similar office in Kuala Lumpur, Malaysia was opened earlier, indicating a move towards closer economic cooperation with Asia. Also, a new $267m steel plant was established during 2006 at Yanbu Industrial City II and is expected to come on-stream in the second half of 2008 with estimated production capacity of 1m/tpy.

Financial Services and the Banking Sector

In September 2006, the rating agency Fitch published its Bank Systemic Risk Report. In the report, Bahrain, Kuwait, Qatar, and Saudi Arabia were among the B category, in line with developed countries in terms of Banking System Indicator (BSI). Oman and the UAE were among the C category of BSI[2].

In 2006, four Islamic banks have been set up, one of them is an Islamic investment bank, set up in Doha and promoted by Bahrain's Gulf Finance House (GFH) and Qatar Islamic Bank (QIB) with paid-up capital of $500m. It offers Shari'a compliant financing. In Bahrain, three Islamic banks were granted licenses to operate, namely, Al-Masref, with authorized capital of $20bn, which is believed to be the largest Islamic bank in the world. The other two are the Yazi Bank, and Ithmaar Bank. During the year, the Central Bank of Bahrain announced details of a comprehensive package of regulatory reforms to modernize and strengthen the licensing framework for banks operating in the kingdom.

In Saudi Arabia, Inmaa bank was launced with capital of SR15bn ($4bn) in March 2006 of which 30% is owned by government bodies while the remaining 70% will be offered in an IPO in 2007. Expatriates were allowed to invest directly in the local stock market in 2006, and in July 2006, the Saudi government introduced legislation governing the issuance of Islamic bonds (Sukuk). The Kingdom announced plans for a new financial district in Riyadh with construction starting in 2007.

The UAE has launched its first credit bureau, Emcredit, in November, which aims to improve corporate transparency and to provide Small and Medium-sized Enterprises (SMEs) with better access to credit information.

In Oman, the government is taking 30 percent equity stake in Dubai Mercantile Exchange (DME) therefore becoming a strategic partner and a key shareholder. This would enable Oman to use the daily value of DME's Oman Crude oil future contract as a benchmark for pricing its crude, beginning in Q1 2007[3].

The shares of Al Baraka Banking Group (ABG) were listed on the Dubai International Financial Exchange (DIFX) in September, simultaneously with a listing on the Bahrain Stock Exchange (BSE). ABG will be the first Bahraini organization and the first Islamic banking group from the GCC to list on the DIFX.

The number of Initial Public Offerings (IPOs) have more than doubled from 12 IPOs in 2004 to 25 IPOs in 2005 and was estimated to be 23 IPOs by end of 2006, of which 11 IPOs have been in Saudi Arabia alone compared to six IPOs in 2005[4]. The most prominent IPOs were: Gulf Navigation Company, Emaar Economic City (EEC), Saudi International Petrochemical Company (Sipchem), Albaraka Banking Group, Dubai Financial Market; Al-Babtain Power and Telecommunication

1 Source: www.mees.com – November 2006.

2 BSI: Banking System Indicator – The BSI is a measure of intrinsic banking system quality or strength derived from Fitch's individual bank ratings.

3 MEES 13 – 20 November 2006.

4 Riyad Bank, Weekly Economic Briefing, December 9 2006.

Company. The increase in IPOs reflect investors' optimism and confidence in the region's prospects.

With respect to sources of financing, the region had witnessed many Gulf energy bonds during 2006, since Qatar's RasGas became a pioneer by launching the region's first energy corporate bond in 1996. Qatar Petroleum issued a $1.55bn eurobond; Saudi Basic Industries Corporation (SABIC) launched the kingdom's first corporate bond worth SR3bn ($800mn), a Shari'a compliant sukuk, and received $1bn in Murabaha financing from Deutsche bank, while SABIC Europe, issued euro 750m bond. Aabar Petroleum Co., issued $460m sukuk; Qatar Petroleum issued $650m Eurobond; UAE's Abu Dhabi National Energy Company (TAQA) issued a $3.5bn corporate bond, the largest-ever in the MENA region, with seven-year euro 550m, ten-year $1bn, and 30-year $1.5bn tranches. Qatar Gas Transport Company (Nakilat) announced intentions to issue a corporate bond. The International Methanol Company's (IMC) used Ijara (leasing) structure worth $180m. During 2006, Arab Banking Corporation (ABC) launched the syndication for United Stainless Steel Company's (USCO) $153mn loan. The company was established in 2005 by Gulf Investment Corporation (GIC) and other public and private shareholders. The loan will be used to part finance the construction of a 90,000 tpy cold rolled stainless steel mill in Bahrain's Hidd Industrial Area. The National Industrial Gases Company (GAS), an affiliate of SABIC, signed a SR1.2bn ($320m) Islamic loan agreement with Banque Saudi Fransi (BSF). All these financing arrangements are signs of the robustness of the businesses operating in the region and their positive future outlook.

GCC Equity Markets

Performance Highlights

The sharp gains of 2005 were replaced by negative returns for 2006, as markets across the GCC corrected sharply. The GIC Composite Index closed the year at 5181.78, down by 43.09% for the year. This contrasts with the gains of 116.8% and 69.2% in 2005 and 2004 respectively. However, despite the corrections in 2006, the long-term returns in the GCC markets continue to out-pace those for the international and emerging markets.

Saudi Arabia, best performer in 2005, was the worst performing market in 2006, as the GIC Saudi Index closed down by 58.17%. Both the UAE and Qatar indices did not fair better, losing 43.96% and 40.06%, respectively. Kuwait ranked third amongst its GCC companions, as the index shed 4.04% for the year. The only indices that managed positive performances were Bahrain and Oman, recording moderate gains of 8.16% and 2.8%, respectively. However, in market cap these two represent only 6.2% of the GCC total.

The market sell-off in 2006 was largely a reaction to the bubble-like valuations created during 2005, as investor sentiment and soaring prices outpaced the growth of earnings by a significant margin.

Sharp corrections in the GCC markets during the year sparked by a sudden sell-off in Saudi Arabia, that in turn was triggered by a psychological shift rather than a shift in fundamentals. The correction was amplified by selling on account of margin calls, which led to further declines. The contraction in year-on-year performance of regional companies dampened the sentiment further.

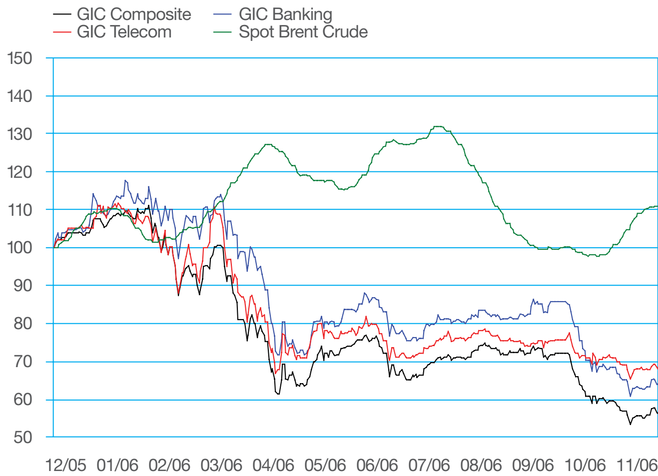
The prevalent geo-political tensions in the region, including the Israeli attack on Lebanon in the summer, the issue of the nature of Iran's nuclear activities, and escalating unrest in Iraq dampened overall performance across the markets during the year. A deflation of oil prices in the third quarter led investors to take a defensive position on the markets. A number of public offerings in the markets dampened the markets further by siphoning off liquidity

The Kuwaiti market witnessed turbulence during the last quarter of the year on account of corporate governance issues, and cancellation of Government contracts. Meanwhile, the Bahraini and Omani markets remained largely unaffected by the sharp corrections, as investors were attracted by the high levels of transparency and disclosure, coupled with reasonable valuations.

However, it is to be noted that the decline in growth of earnings during 2006 was largely on account of an erosion in investment income that had padded up the profitability of most companies during 2005. Nevertheless, core operating growth remains on track, and the performance of companies is likely to improve going forward, as the economy continues to expand.

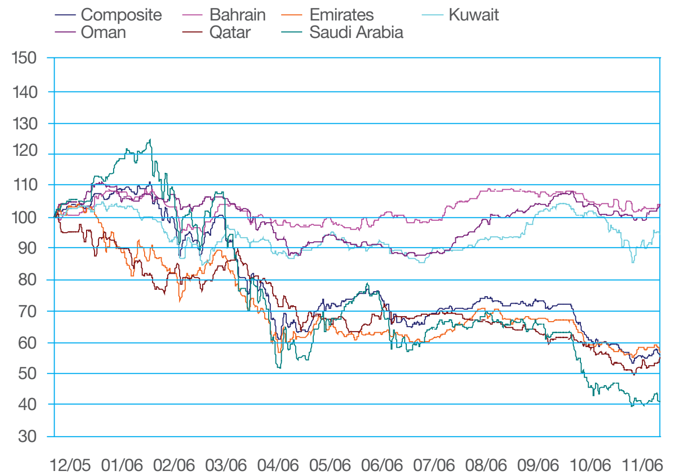
The regional markets underperformed the world markets by a significant margin, with a late year rally on the international benchmarks exacerbating the gap further. In contrast to 2005, the returns on the Morgan Stanley Capital International's (MSCI) World Index and Emerging Markets Index scored markedly robust returns of 20.72% and 32.20%, respectively.

Figure 2: Composite and Sector Performance Relative to Crude Oil



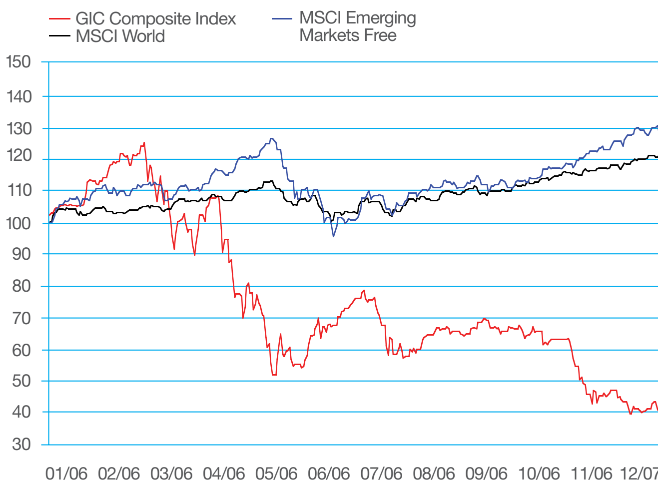
Source: GIC Equity Research Department.

Figure 3: Individual Country Indices Performance (Normalized)



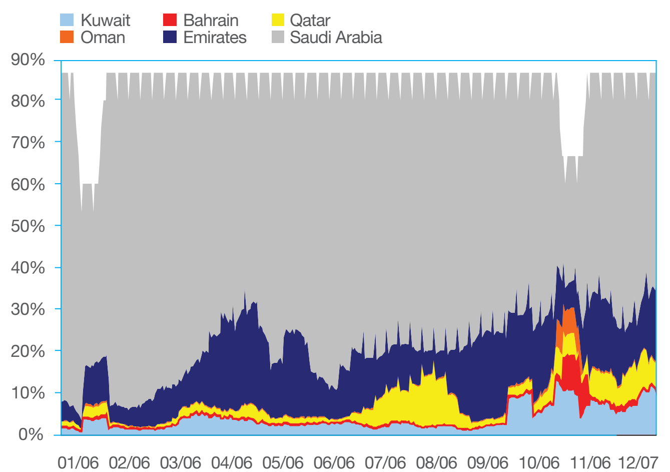
Source: GIC Equity Research Department.

Figure 4: Relative Performance vs World Markets



Source: GIC Equity Research Department, Morgan Stanley Capital International.

Figure 5: Contributions to Value Traded



Source: GIC Equity Research Department.

Table XV: GIC Index Performance

GIC Composite Index Performance	
GIC Composite Index Closing Value	5181.78
Value Traded ($ m)	1091181
Value Traded Previous Year ($ m)	1085826
Change During Year	-43.09%
Change During Previous Year	116.8%
Market Cap ($ m)	294207
Country Index Performance	
Bahrain	8.6%
Emirates	-43.96%
Kuwait	-4.04%
Oman	2.8%
Qatar	-40.6%
Saudi Arabia	-58.17%
Sector Index Performance	
Banking	-33.49%
Telecom	-32.56%

Source: GIC Equity Research Department.

Volumes regressed throughout the region, as trading activity plummeted in most of the GCC countries. The first quarter of the year saw the GIC Composite's trading value surge by 176.32% in comparison to Q1'05, hence explaining the Composite's all-time record set in February '06. The latter quarters saw trading value levels fall 5.62%, 9.36%, and a whopping 61.48% for Q2'06, Q3'06 and Q4'06, respectively, compared to their '05 counterparts. The total traded value was recorded at US$ 1092 bn, 0.43% higher than the previous year.

Trading activity was still dominated by Saudi Arabia, representing 85.07% of the total traded value, thus underscoring its status as the most liquid market in the region. Emirates and Kuwait retained their positions as the second and third most liquid markets despite falling below last year's levels. Qatar remains the fourth most liquid market: its stake grew 23% increasing its contribution to 2.32%, thus maintaining its liquidity growth trend. Kuwait and Bahrain demonstrated the greatest differences with a 30.02% and 20.5% drop in their liquidity levels. Meanwhile, Oman remained in sync with its level for the previous year.

The aggregate market capitalization for the constituents of the GIC Composite Index dropped from US$ 503.7bn at the beginning of 2006, to US$ 294.207bn, as a consequence of the harsh correction during the year.

Volatility soared throughout the GCC region in context with the bubble burst phenomena that was manifested during the year. This is clearly portrayed with the negative annualized returns apparent in most GCC markets. All but Bahrain and Oman displayed negative characteristics, though Bahrain's volatility has been considerably higher compared to historic ratios. Oman seems to be the only market where a lower volatility materialized in contrast to historic recorded levels.

Economic Review continued

The fall in stock prices through most of the region, in addition to continuing earnings growth, resulted in a considerable drop in PE multiples. The drop in prices also boosted dividend yield from previous levels, though not sufficiently to expel the ill sentiment prevalent during the year.

Major Trends of the Year

Correlation with World Markets

The prevailing trend during the past years in relation to the MSCI World and MSCI Emerging Markets Indices and the GCC Composite, was a clear-cut correlation in terms of direction, though not in magnitude. In the recent past, the GCC region had outperformed both benchmarks by a significant margin.

However, during this year, the MSCI World and Emerging Markets indices continued their upward trend (with a high correlation ratio of over 0.8 between themselves), while the GCC Indices moved in the opposite direction, thus resulting in negative correlation between the two sets. The accelerated growth phase attributed to the GCC region during 2005 ignited a classic correction during 2006, and in turn resulted in this negative correlation.

Figure 9 shows that there has been a strong correlation between Brent crude oil spot prices and the GIC Composite Index. This is explained by the fact that oil revenues are the main source of income for most of the GCC countries. Hence oil price defines the pace for economic development in the region. Year 2006 was an exception in the sense that the correlation turned negative. Brent crude oil spot price was pushed by several factors, where as the GCC market sell-off was rationalized by geopolitical tensions and the bubble-like valuations rather than a shift in economic fundamentals.

Composite Weightings

With the addition of newly listed companies across regional exchanges and due to the continuing trend of privatization, 2006 saw a slight change in sectoral weightings. Banking remains the most dominant sector within the GIC composite with a 34.4% weight, down from 35.6% at the end of 2005. The Telecom sector underwent a slight increase due to the listing of Emirates Integrated Telecommunications Company in the UAE. The representation of the Financial and Real Estate sectors also increased from 17.3% to 18% due to numerous listings. Over the year, the weight of the Industrial sector declined from 22.3% to 20.1%. In consequence, Banking still remains the most weighted sector followed by Industrial, Finance and Real Estate, and Telecom, respectively, thus showing no significant change in sectoral ranking.

Shifts in Country Weights

Saudi Arabia's weight within the index underwent a drastic change from last year's level, dropping from 68% to 39.6%. This gave room for the more stable markets, categorized by Kuwait, Bahrain, and Oman, to grow. Although Emirates' weighting grew from the previous year, it was overshadowed by Kuwait's sweep to overtake it as the second highest weighted representation within the index. Other than these, all other countries maintained their rankings.

Investors in GCC equity markets, who suffered corrections and volatility during 2006, should expect a better year in 2007, supported by a reasonably optimistic view of the fundamentals of the GCC economies.

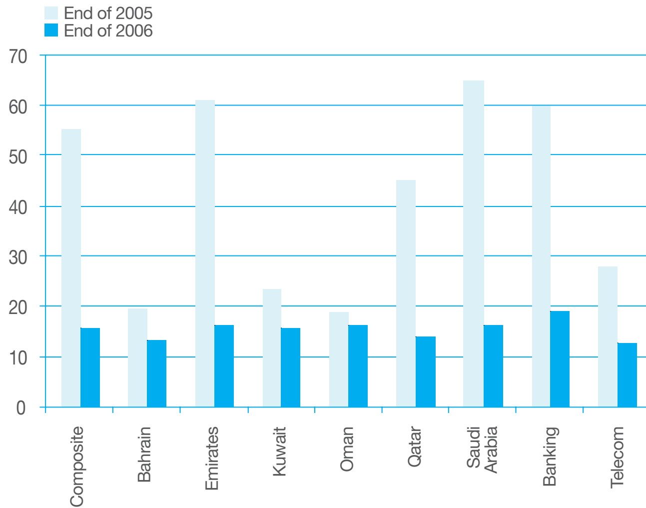
Table XVI: Risk/Return Analysis

	Annualized Return	Annualized Standard Deviation of Daily Returns (12 months of Data)
	2006 Data	
Composite	-43.09%	32.7%
Bahrain	8.16%	14.0%
Emirates	-43.96%	34.3%
Kuwait	-4.04%	20.7%
Oman	2.8%	14.2%
Qatar	-40.6%	57.1%
Saudi Arabia	-58.17%	57.1%
Banking	-33.49%	34.8%
MSCI World	20.72%	10.1%
MSCI EMF	32.2%	18.3%
	2001 – 2005 Data	
Composite	53.2%	11.7%
Bahrain	23.5%	10.8%
Emirates	62.2%	17.4%
Kuwait	44.2%	15.8%
Oman	26.1%	14.5%
Qatar	63.0%	20.3%
Saudi Arabia	53.5%	18.5%
Banking	47.3%	11.1%
Telecom	48.3%	13.6%
MSCI World	2.7%	14.1%
MSCI EMF	18.8%	15.1%

Source: GIC Equity Research Department, Morgan Stanley Capital International.

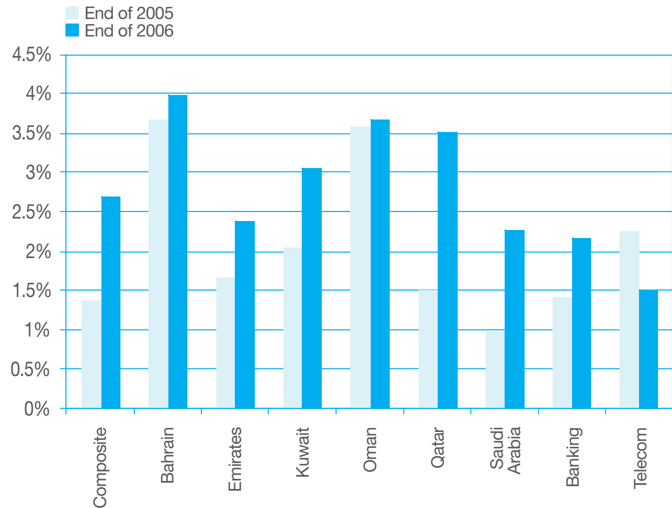
Economic Review continued

Figure 6: GIC Composite Trailing PEs



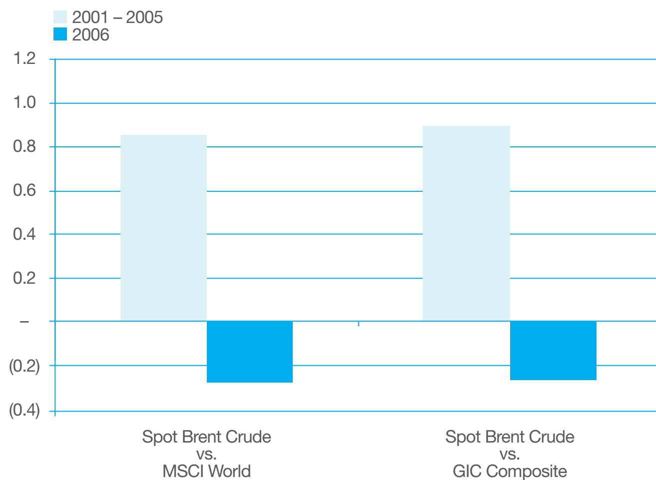
Source: GIC Equity Research Department, Regional Exchanges.

Figure 7: GIC Composite Dividend Yields



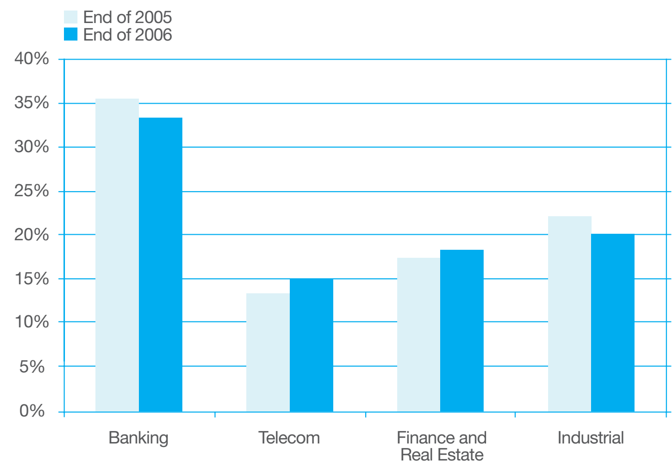
Source: GIC Equity Research Department, Regional Exchanges.

Figure 9: Correlations Between Stock Indices and Crude Oil



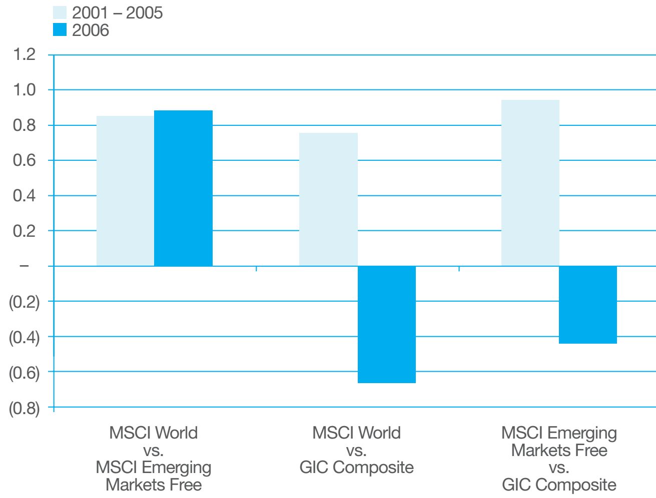
Source: GIC Equity Research Department, Morgan Stanley Capital International, Reuters.

Figure 10: GIC Sector Weights



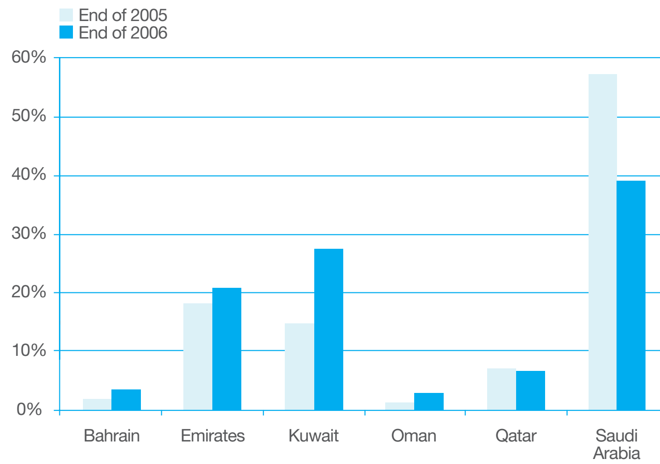
Source: GIC Equity Research Department.

Figure 8: Correlations Between Stock Indices



Source: GIC Equity Research Department, Morgan Stanley Capital International.

Figure 11: GIC Country Weights



Source: GIC Equity Research Department.

In 2006, GIC introduced innovative investment offers in Structured Products and Real Estate. The Global Markets team continues to lead the markets developing sophisticated products for both regional and international investors.

Qatar Central Ba
200
ANK OF OMAN
KUWAIT
20

Our Financial Goal:
To maximize long-term shareholder value through consistently superior financial performance while maintaining strong financial condition.

Our Financial Performance Objective:
To consistently achieve target earnings growth and return on equity, with an appropriate dividend payout.

Our Financial Condition Objective:
To efficiently manage the various forms of risks associated with our business and maintain strong asset quality, capital base and liquidity, while achieving target balance sheet growth.

Net Income Analysis

For the first time in Gulf Investment Corporation's history, net income recorded above 100% growth for the second consecutive year. Income continued to rise for the sixth successive year. At US$ 600.1 million net income for the year was US$ 327.3 million or 120.0% up on the prior year. This represents a return on adjusted average equity of 42.9% compared to 22.5% in 2005, and a return on paid-up capital of 80.0% compared to 36.4% in the previous year.

Performance of the year 2006 endorsed GIC's vision of long-term growth in ever changing economic scenario. GIC maintained to achieve superior level of profitability on the strength of its core investments, diversified blend of investment activities, and dynamics of asset mix in an increasing interest rate environment where spread-based investments became even more challenging.

Gross operating income at US$ 550.4 million leapt by 66.9% over the previous year. Analysis of the contributing components confirms the accomplishment of GIC's major objectives and strength of investment philosophy.

Interest and Similar Income

Interest income is generated from debt securities portfolio, structured products, proceed from money market book, returns on the outstanding receivable from shareholders, credit funds and loans.

Gross interest and similar income grew by 32.6% to US$ 254.4 million during 2006.

Investment in interest bearing securities and funds is primarily made to generate spread income. Upward movement in interest rates made it a testing task to enhance this income. GIC anticipated this scenario much in advance and the negative impact of increasing interest rates has been partially mitigated through the hedging of a major portion of long duration fixed rate debt securities. This also enabled us to lock-in future earnings at the most opportune time.

Margin income on debt securities nevertheless decreased in 2006. To capture the trend and to enhance the spread income, GIC envisaged a change in product mix by introducing structured products portfolio, initial results of which are encouraging.

GIC's money market activity continued to generate strong interest earnings in 2006, which shows commendable growth of 46.4% on the prior year.

The outstanding balance of 'Due from Shareholders', arising from the sale of GIB in 2001 was settled in full from dividend for the year 2005 distributed by the Corporation in the current year. Income from this receivable was US$ 0.2 million compared to US$ 2.5 million in 2005. Detail of this transaction is provided in Note 7 of the financial statements.

Investments in credit funds have been made as loan replacement vehicles, with credit funds offering superior risk adjusted returns. Though the gross interest income increased by 29.5% compared to previous year, net margins were under pressure. Income from declining loan book almost remained at the prior year level of US$ 1.5 million due to increase in interest rate.

The corporation's interest rate sensitivity gap is set out in Note 25.2 to the financial statements. Exposure to interest rate risk is restricted due to the limited mismatch between the repricing of majority of the Corporation's assets and liabilities.

Investment and Fee Income

Investment and fee income for the year at US$ 405.5 million posted an increase of 31.2% over the year 2005 comparative income. Results of GIC's long-term strategy to contribute to the growth of GCC region at a commercial rate of return started corroborating with the strong performance growth of investments in GCC projects. Judicious allocation of other investments made for risk diversification added to the outstanding results for the year.

A detailed breakdown of investment and fee income is available in Note 18 to the financial statements. The key constituents are discussed below.

Net gain on interest bearing securities and funds rose to US$ 23.3 million, an increase of 73.9% on the prior year. This includes gains from sale and market value changes of debt funds held for trading, which substitute the interest income. Significant growth in income for the current year was mainly due to increase in the volume of investment in managed debt funds.

Net gains on equities and managed funds at US$ 109.2 million, recorded an increase of US$ 14.8 million or 15.7% up on the prior year. GIC's equity exposure witnessed mixed performance in 2006. Remarkable results achieved by alternative equity investments and global equity portfolios were mostly offset by losses in GCC equities. Alternative equity investments mainly comprising hedge funds posted record earnings for the year. Such investments cover a broad range of strategies including relative value, event driven, long-short, global macro, and are managed by a well diversified pool of external managers.

Financial Review
continued

Historical record bull-run of 2005 in GCC equity markets peaked in the beginning of 2006 and then continued to drift throughout the year. Performance of GIC's equity exposure in GCC almost matched with the market.

Net gains of US$ 122.5 million realized from the sale of few projects and some partial liquidation were up by 172.2% over the previous year. Pre-determined strategic exit points, restructuring of the portfolio coupled with market opportunities translated into vision realization.

Income from investments in private equity funds increased to US$ 27.7million in 2006 from US$ 26.7 million in the previous year. In addition, dividends of US$ 3.5 million received during the year are included under 'Dividend Income'.

Management believe that the gradual recovery witnessed by the global private equity sector since 2005 is likely to continue in the future.

Projects and equity participations posted earnings of US$ 75.1 million, lower by 15.7% compared to prior year. This represents mainly GIC's share of profits from unconsolidated subsidiaries and associated companies. Additionally, dividend income of US$ 6.4 million was earned and is included within the 'Dividend Income' category. Though the key projects continued to perform well, losses incurred by green field ventures in start-up mode and initial impact of restructuring in few projects partially affected the overall performance for the year. Financial results of new ventures indicate the activity as planned towards the completion of conceived projects, which are expected to make significant contribution in the coming years. Further, GIC has won major projects in power, utilities and other sectors. Holding companies are being established to consolidate interest in various sectors. All these are expected to sustain the future growth.

With representation on the Board of Directors of most of the projects, the principal investing team plays an active role in the strategic management of these companies and continuously monitors performance. GIC adheres to a policy of strict financial discipline while evaluating and managing project investments, seeking ventures that will provide a market rate of return.

Dividend income of US$ 17.8 million, comprising of receipts from private equity funds, project investments, managed portfolios and funds, declined by 17.6% compared to prior year. Partial sale of dividend yielding investments in projects and lower dividends from private equity funds mainly contributed to the drop in income, which was significantly offset by higher dividends from managed portfolios and funds.

Fees, commissions and sundry income earned totaled US$ 29.5 million, an increase of 59.5% on the prior year. Fee income was generated by management of funds, financial advisory, development of projects and providing custodial and administrative services to the funds managed by third parties. The business development team aims to deliver a range of financial products available in the international markets to a regional clientele, in addition to the sale of internally developed GCC investment products to clients in and outside the region. Emphasis will continue to be on expansion of fee-based revenues to help diversify revenue sources into lower risk assets with lower capital utilization.

Income from Recovery of Debt

GIC's efforts for recovery of written off loans to entities within Republic of Iraq paid off with the receipt of 5.8% Iraqi sovereign bonds having fair value of US$ 111.4 million in final settlement during the current year. Detail of this income is provided in Note 21 of financial statements.

Operating Expenses

Operating expenses at US$ 56.2 million were US$ 10.7 million or 23.5% up on the prior year. Year-on-year increase was recorded in all the major expenses. For successful growth of a dynamic and entrepreneurial organization, investment is required to be made in people, technology and the future.

Staff cost constituting 61.0% of the total operating expenses increased by US$ 6.1 million compared to prior year. This was primarily due to retain and attract the best in the industry to meet the growth requirements and also to suitably reward significantly the stronger performance.

Productivity ratio in terms of profit per employee was the highest ever and the staff cost to income was at its lowest indicating high level of efficiency.

Increase in premises expenses to US$ 3.5 million from US$ 2.6 million in the prior year was mainly due to relocating back office functions for deriving further efficiencies.

Other operating expenses increased by 24.6% in the current year representing mainly rise in expenses related to training, information technology and representative offices etc., required for the envisaged expansion in future activities.

Provisions for Impairment Losses

We maintain provisions to absorb losses inherent in our business that we believe are probable and that can be reasonably estimated. Given the varied nature of businesses, these may arise from our lending, treasury and investment activities. Estimating losses is inherently uncertain and depends on many factors, including general, macroeconomic and political conditions, rating migration, risk concentration, structural changes within industries, and other external factors such as legal and regulatory requirements. The Corporation periodically reviews such factors and reassesses the adequacy of the provisions.

Net charge for the year in provisions was US$ 5.5 million, lower by US$ 5.9 million charged in 2005. Provisions for the current year included US$ 5.0 million for decline in the value of private equity funds and US$ 1.3 million on loans and guarantees. Excess provisions of US$ 0.8 million pertaining to placements with non-bank financial institutions, accounts receivables and interest bearing securities held-to-maturity were reversed. A detailed break down is provided in Note 22 to the financial statements.

Balance Sheet Analysis

In line with our aim of optimizing capital utilization through the growth of total assets and an emphasis on risk adjusted return criterion in asset allocation decisions, total assets during the year reached US$ 8,113.1 million, up 9.0% over the previous year end. 2006 witnessed a substantially more balanced expansion in assets within the principal investing activity and private equity funds, both of which registered double digit growth. Diversification in sources of revenue was further enhanced during 2006 with investments being made in products with superior risk-return characteristics.

The Corporation's strategic focus continues to be on the GCC states and their major trading partners in the industrialized world. Note 25.6 to the financial statements sets out the geographic distribution of the Corporation's assets.

The following sections provide details on the key asset categories.

Interest Bearing Securities and Funds

As at 31 December 2006, interest bearing securities and funds made up 58.5% of GIC's total balance sheet assets. The portfolio witnessed a net increase of 6.4% during the year. This was largely contributed by new investments in the nature of structured products and the inclusion of the Iraq Government Bonds received in settlement of amounts due from entities within the Republic of Iraq. This portfolio was established to provide stable coupon/spread income and as a reserve of additional liquidity. With almost over 73% of the portfolio allocated to securities within North America and Europe, and covering a wide range of sectors, geographic and industry risk diversification is also achieved vis-à-vis GIC's other GCC based investments. The investment within the portfolio is composed mostly of investment grade marketable debt securities. Investments in trading funds, at US$ 397.3 million, which are interest-rate related, form less than 8.5% of this portfolio.

Interest bearing securities totaled US$ 4,349.0 million at 31 December 2006 as against US$ 4,097.2 million at end of 2005. The interest bearing securities portfolio includes securities available for sale of US$ 3,766.3 million and securities held to maturity of US$ 582.7 million. Approximately 92% of the debt portion of the investment portfolio is made up of plain floating rates notes or fixed rate securities swapped into floating rate using interest rate swaps. The balance comprises fixed rate securities of a shorter duration.

The high quality of the portfolio is reflected in the unrealized gains associated with the portfolio. Approximately US$ 34.7 million in unrealized gains relating to interest bearing securities available for sale were included within shareholders' equity as at year end 2006. Within the held to maturity portion, the fair value of holdings exceeds book value by approximately US$ 1.7 million. These significant increases in market value are indicative of the superior quality of holdings within the portfolio. Within the held to maturity portion, US$ 0.4 million of provisions were reversed during the year as a result of improvement in quality. A credit risk analysis of the investment securities portfolio is provided in the risk management section on Page 39, and other details, including rating profile, are contained in Note 4 to the financial statements.

Loans

This category includes loans and advances of US$ 17.0 million. Outstanding loans declined by 42.9% year-on-year, in line with the strategic decision to discontinue this business and allow loans to run off.

Based on contractual maturities at the balance sheet date, approximately 48.2% of the current outstanding loans are due to mature by the end of 2007. Details of the maturity profile are given in Note 25.1 to the financial statements and other details including loss provision made are contained in Note 6 to the financial statements. As of 31 December 2006, loans and advances were entirely to customers within the GCC region. There were also no significant concentrations by industrial sector at the year end.

Total loan loss provisions including loan guarantees amounted to US$ 5.4 million at 31 December 2006. Counter-party specific provisions amounted to US$ 3.3 million while general provisions were US $2.1 million. The specific provisions were made against loans, guarantees and related exposures to project investments. Specific provisions for loans are made to the full extent of the estimated potential loss while general provisions are maintained to cover possible future losses which as yet have not been specifically identified. It is the Corporation's policy to write off loans after all reasonable restructuring and collection activities have taken place and the possibility of further recovery is considered to be remote.

Equities and Managed Funds

Equities and managed funds totaled US$ 1,153.7 million at 31 December 2006 as against US$ 1,180.3 million at end of 2005 indicating a net decline of 2.3% during 2006. Equities and managed funds include available for sale securities of US$ 323.0 million and equities and managed funds classified as trading and 'fair value through income statement' of US$ 233.1 million and US$ 597.5 million respectively. A decline of almost 22.1% was witnessed in equities and managed funds available for sale, which was largely brought about by the liquidation of positions within the global equity and GCC strategic equity portfolios. The bulk of the remaining portfolio of equities and managed funds broadly classified as trading comprises of investments in a range of alternative asset strategies, managed by a diverse pool of external managers. The portfolio of alternative asset investments is continuously monitored and restructured to fit GIC's risk-return profile, while gradually expanded in line with growth targets. The Alternative Strategies Fund (ASF), managed by GIC in association with internationally reputed managers had another successful year.

Placements and Other Interest Bearing Assets

Placements amounted to US$ 647.6 million at 2006 year end. Reciprocity is a key feature of our placement policy. Note 25.1 to the financial statements provide the contractual maturity profile of placements. All placements mature within one year. Of this, US$ 236.6 million had a maturity within three months. Only 12.27% of total placements were with non-bank financial institutions. Securities purchased under resale agreements amounted to US$ 13.7 million at 31 December 2006 compared to US$ 24.6 million at end 2005. Other liquid assets at the balance sheet date included US$ 4.3 million cash and bank balances.

Placements during the year are shown net of provisions amounting to US$ 1.6 million, being 2% general provision in accordance with Central Bank of Kuwait instructions on placements with non-bank financial institutions which stood at US$ 79.7 million at year end 2006.

Private Equity Funds

Private Equity funds amounted to US$ 226.5 million at December 31, 2006, up 23.0% compared to the prior year. The portfolio is principally invested in equity investments of a structured finance nature with a wide range of externally managed private equity funds. These funds invest in leveraged and un-leveraged acquisitions, privatizations, recapitalization, rapidly growing companies, expansion financings, turnaround situations and other special equity situations.

With the exception of listed equity investments, where fair value is reliably discernible, investments in equity funds are carried at cost. Provisions for other than temporary decline in value, determined on an individual basis, amounted to US$ 37.8 million at the reporting year end. During 2006 additional provisions of US$ 5.0 million were made against expected value diminution in certain investments. Details on equity funds are provided in Note 8 to the financial statements.

Investment in Project Held for Sale

As enumerated in Note 9 to the financial statements, on May 27, 2006 the Corporation acquired the remaining 50% of the shares outstanding of Gulf Industrial Investment Company (E.C.) for a consideration of US$ 377.0 million. Subsequently, 25% of the investment was sold. The amount of US$ 198.4 million represents the remaining 25% of the investment which has been sold in January 2007.

Investment in Projects and Equity Participations

Investments in projects and equity participations amounted to US$ 878.5 million at the end of 2006, compared to US$ 736.2 million at the end of 2005. A marked increase of 19% over previous year. This category includes a mix of investments in unconsolidated GCC and other subsidiaries and equity stakes in GCC companies.

During 2006, the principal investing team was active in all fronts. This included restructuring of existing investments which entailed the complete exit from five projects, partial sale of two quoted projects, additional investment in existing projects and new investments in four new projects. The principal investing team also conducted exhaustive appraisals of several other projects, some of which have been approved or are in the final stages of approval. New additions included investments in diversified projects comprising of infrastructure projects, financial services and logistics.

Net provisions during the year remained at the same levels of 2005. Detailed analysis of the portfolio and related provisions is contained in Note 10 to the financial statements. A list of the Corporation's direct investments is also given on Page 99.

Receivable from Shareholders

The outstanding receivable balance 'Due from shareholders' of US$ 52.4 million as at end of 2005 representing the unpaid balance from the sale of Gulf International Bank (GIB) to the shareholders on April 7, 2001 was fully settled along with interest from dividends distributed by the Corporation during 2006. Note 7 to the financial statements provide additional details.

Property and Other Assets

Including property and fixed assets, total other assets amounted to US$ 227.1 million at 31 December 2006. Of this US$ 20.4 million related to property and other fixed assets. The remaining US$ 206.7 million comprised of accrued interest and fees receivable, derivative assets used for hedging, employees' end of service benefit asset, accounts receivable, prepaid expenses and other miscellaneous assets. Details are set out in Notes 11 and 12 to the financial statements.

A more detailed discussion on liquidity and funding, the various risks associated with our business activities, and capital strength is included in the Risk management section.

GIC is a major provider of metals to the GCC's construction and manufacturing sectors. GIC has created the first fully integrated steel company in the region and it is bringing together major regional public and private investors who share the same strategic interests.

Risk Management

The financial goal of the Corporation is to consistently earn competitive returns, while maintaining risks within acceptable levels. Recognizing the relationship between returns and risk, the management of risk forms an integral part of the Corporation's strategic objective. The continuous and rapidly changing business environment has increased the complexity and diversity of risks. The goal of risk management is not to avoid risks, but to understand and manage them.

The various business activities of the Corporation generate a wide spectrum of risks. The four primary risks assessed are credit, market, liquidity and operational. Management of these risks through investment in knowledge and systems has been a priority at GIC. A combination of competent and experienced staff, quantitatively based analytical tools, and ongoing investment in technology are the key resources used to manage our risks effectively. The qualitative and quantitative techniques utilized to optimize the risk return profile incorporate information from the past, trends in the present business environment, and expectations of the future.

Risk management begins with management defining its risk appetite. This is followed by a three step process: identifying and measuring the various risks generated, monitoring and controlling them, and finally optimizing in relation to return.

The primary function of the independent Risk Management Division is to develop and maintain a common risk management framework that serves as a basis for setting policies and limits and for enhancing GIC's ability to manage risks, evaluate performance and allocate capital. This unit acts as a critical link between management and the risk taking divisions – assisting management in defining/quantifying its risk appetite and then effectively communicating this to the risk takers and ensuring that the risk taking activity is within management's acceptable levels.

In line with overall corporate expansion and growth plans, several initiatives were implemented within the Risk Management Division during 2006. Significant among these was the setting up of a separate Operational Risk Management Unit within the division, staffed with skilled professionals specifically recruited for the unit. Resources within the Credit and Market Risk Management units were also augmented, enhancing overall risk management capabilities. During the year the division also set up dynamic Value at Risk (VaR) based limits for relevant risk categories, and drew up detailed policy documents, significantly enhancing the robustness of the risk management framework within GIC.

Within the Corporation, responsibility for management of risks is not restricted to a single division. The philosophy adopted has been to encourage a culture of prudent risk management across all business and support areas.

From the perspective of control, the process of risk management is facilitated through a set of independent functions in addition to the Risk Management Division. These units, which report directly to senior management, include Financial Control, Internal Audit and Compliance. This multi-faceted approach aids the effective management of risks by identifying and monitoring risks from a variety of perspectives.

The process of managing the four risk categories identified here are discussed in more detail in the following sections.

Credit Risk

Credit risk is the possibility of loss arising from the failure of an obligor to completely fulfill its contractual obligations. In its various on and off-balance sheet business activities, the Corporation seeks opportunities to take credit risk prudently and manage it effectively to achieve competitive returns. Credit risk is managed concurrently at the transaction, obligor and portfolio levels.

An activity-wise break down of the principal sources of credit risk is illustrated in the pie chart on Page 40.

The primary tool used in the management of credit risk is a set of well defined credit policies and procedures. In addition to communicating management's risk appetite in the form of limits for country, product, industry and obligor, these policies detail the process of measurement, monitoring and reporting. The stringent credit approval framework mandates a rigorous and thorough evaluation of creditworthiness of each obligor, after which limits are approved by management. Additionally, limits for product and industry are also defined to ensure broad diversification of credit risk. Credit policies and procedures are designed to identify, at an early stage, exposures which require more detailed monitoring and review.

The credit risk management process utilizes statistical methods as well, to estimate expected and unexpected loss amounts for the various business activities. The system, based on Creditmetrics methodology, enables accurate credit risk measurement on an

Sources of Credit Risk

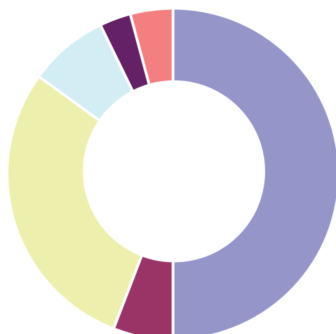


Table I: 2006 Credit Value at Risk – 99.6% confidence level, one year holding period

	Debt Portfolios (US$ 000s)
Average	165,385
Minimum	156,077
Maximum	172,175
31 Dec 2006	161,093

individual exposure as well as a portfolio basis. Expected and Unexpected loss estimates are computed based on probabilities of default (PD) and loss given default (LGD) data published by leading rating agencies.

During the year a new set of VaR limits were established for the Debt portfolio, which forms the largest asset class and constitutes approximately 45% of the balance sheet. The US$ 200 million VaR limit (99.96% confidence, 1 year), which supplements the existing notional limits for this portfolio, is based on Creditmetrics methodology and is measured using Montecarlo simulation techniques.

The table above provides the Credit Value at Risk (Credit VaR) figures for the Debt Portfolios. The market value of this portfolio at 31st December 2006 was US$ 4,350 million and at 31st December 2005 was US$ 4,099 million.

Although, business units are responsible for maintaining exposures within limits, actual exposures are continuously monitored by independent control functions including Risk Management, Financial Control, Compliance and Internal Audit. Technology is a key element in the monitoring process and in this regard, cutting edge systems, capable of close to real time monitoring and control of risk taking activities, are being effectively utilized.

As of end 2006, the key components of the Corporation's total credit risk exposure were investment securities; principal equity investments and equity funds; and credit funds and loans. Approximately 90%, or US$ 3.9 billion of the US$ 4.7 billion interest bearing securities is made up of high-grade securities of which 90% are of issuers rated investment grade or better. High quality credit and other funds constitute the remaining 10% of interest bearing securities and funds.

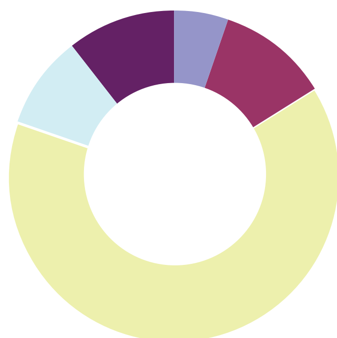
The Superior quality of the portfolio is highlighted in the rating profile on Page 41. Independent compliance and control units continuously monitor the portfolio for adherence to stringent portfolio guidelines.

The principal investments activity focuses on the GCC countries, a region whose dynamics GIC comprehends well and where GIC has a better understanding of the inherent risks. Investments are made after rigorous qualitative and quantitative analysis, and where the desired risk-return objectives are met. As is highlighted in the graph on Page 41, a healthy diversification across industry sectors is maintained within this portfolio.

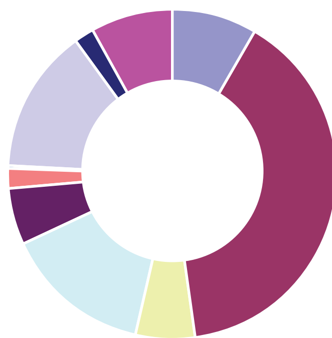
Credit funds, managed by a range of experienced and highly rated fund managers, are invested in superior quality structured finance transactions. The corporation's holdings within these structured investment vehicles are rated investment grade or better.

Risk Management continued

Rating Profile – Interest Bearing Securities & Funds



Principal Investing (Projects) by Industry



The corporation's lending activity is being gradually phased out, with the residual balance in the loan book amounting to just US$ 17 million as of 31 December 2006.

Off-Balance Sheet Financial Instruments

In the normal course of its business, the Corporation utilizes derivative and foreign exchange instruments to meet the financial needs of its customers, to generate trading revenues and to manage its exposure to market risk.

For derivative and foreign exchange transactions, procedures similar to on-balance sheet products are used for measuring and monitoring credit risk. Credit risk weighted exposure to off-balance sheet products amounted to about 2.4% of total credit risk weighted exposure. This amount represents the mark-to-market or replacement cost of these transactions. At year end 2006, there were only trading foreign exchange contracts outstanding, almost all of which were short term with a maturity of less than one year. Credit risk amounts arising from these transactions relate to major banks. Off-balance sheet transactions also include credit-related contingent items designed to meet the financial requirement of the Corporation's customers. A detailed credit risk analysis of credit-related contingent items, derivatives and foreign exchange products is set in Notes 23 and 24 to the financial statements.

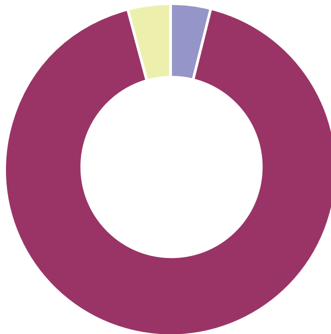
Although, detailed and thorough analysis is conducted prior to taking on credit risk, unforeseen events could trigger a decline in the creditworthiness associated with a transaction, resulting in loss. Adequate levels of provisions are set aside to cover such losses. The corporation's provisioning philosophy, including numerical analysis, is discussed in the financial review section on Page 34.

Market Risk

Market risk is the possibility of loss in value of financial instruments, resulting from an adverse change in market factors. Within the Corporation, market risk is made up of three key risk constituents – interest rate risk, equity risk and foreign exchange risk. A breakdown, based on risk constituents, is provided below for the combined mark-to-market and investment activities, within the Global Markets Group (VaR related to strategic equity positions within the Principal Invesments is not included). The percentages reflect average VaR amounts, considered independently, and ignore the effects of diversification across risk classes.

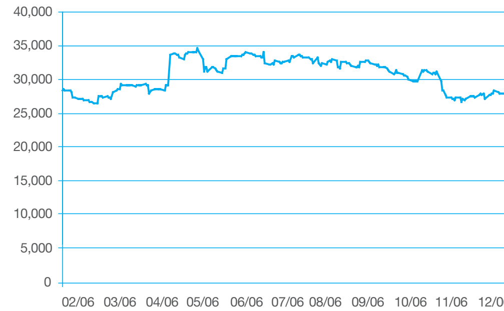
Market risk is measured, monitored and managed, both on a notional basis, and using a Market Value at Risk (Market VaR) concept. Quantitative statistical methods combined with judgment and experience are used to effectively manage market risk. A system of limits and guidelines

Market Risk Constituents – Overall



	8%	Interest Rate Risk
	90%	Equity Risk
	2%	Foreign Exchange Risk

Profile of daily VaR – 25 day holding period, 95% confidence level



restrains the risk taking activity with regard to individual transactions, net positions, volumes, maturities, concentrations, maximum allowable losses, and ensure that risks are within the acceptable levels in terms of notional amounts. The VaR based system provides a more dynamic measure of market risk, capturing in a timely manner, the impact of changes in the business environment on the value of the portfolio of financial instruments.

Market VaR is calculated and reported to senior management on a daily basis at various levels of consolidation including portfolio, business unit and corporation. The average, minimum and maximum value at risk amounts for the combined mark-to-market and investment activities (excluding strategic equity investments within principal investing) are tabulated on Page 43. These VaR measures are based on a 95% confidence level, 25 day holding period, and using exponentially weighted historical market data. A profile of daily VaR is charted above.

During the year Total VaR remained within the approved limit of US$ 35 million, averaging US$ 30.7 million. The average VaR during 2006 was higher than the average for 2005, primarily as a result of increased equity market volatilities within the GCC region. Positions were scaled down and hedging strategies were implemented to subsequently stabilize and lower total VaR levels during the second half of 2006. Interest rate VaR, although moderately higher than the previous year, continued to remain at relatively low levels.

The value at risk associated with exposures to alternative investment strategies is also quantified and aggregated with risk components of GIC's more conventional on and off balance sheet asset classes. At year end 2006, the Total VaR was US$ 28.1 million.

Scenario analysis is an essential component of the market risk management framework. The assumption of normality on which the statistical models are based may become invalid due to the occurrence of certain events. Future scenarios, which result in a breakdown of the historical behavior and relationships between risk constituents, are projected, and potential loss amounts are determined. Most of these scenarios are derived from macroeconomic events of the past, modified with the expectations for the future.

Risk Management continued

2006 Market Value at Risk – 25 day holding period, 95% confidence level

US$ 000s	Average	Minimum	Maximum	31 Dec 2006
Interest rate	2,766	558	4,323	2,938
Equity	29,978	26,124	33,987	27,405
Foreign Exchange	777	282	1,952	466
Total	30,664	26,607	34,646	28,080

Liquidity Risk

Liquidity risk is the failure to meet all present and future financial obligations in a timely manner and without undue effort, whether it is a decrease in liabilities or increase in assets. This risk may be further compounded by the inability of the Corporation to raise funds at an acceptable cost to meet its obligations in due time.

There are two sources of liquidity risk that GIC takes into account, to wit:

a) Cash flow illiquidity, arising from the inability to honor financial commitments or to procure funds at reasonable rates and required maturities; and
b) Asset illiquidity, relating to the lack of market depth during times when assets are to be liquidated on a forced basis.

The corporation likewise believes that capital plays a special role in liquidity planning inasmuch as liquidity problems could arise in the short run if the market believes that capital has been so impaired that in the long run the Corporation may not be able to pay off its liabilities.

GIC's management of liquidity considers an overall balance sheet approach that brings together all sources and uses of liquidity. More specifically, liquidity requirements cover various needs that are addressed by the Corporation's senior management. Among these needs are:

a) meeting day-to-day cash outflows;
b) providing for seasonal fluctuation of sources of funds;
c) providing for cyclical fluctuations in economic conditions that may impact availability of funds;
d) minimizing the adverse impact of potential future changes in market conditions affecting GIC's ability to fund itself; and
e) surviving the consequences of loss of confidence that might induce fund providers to withdraw funding to GIC.

Liquidity Limits

As part of the funding and liquidity plan, liquidity limits, liquidity ratios, market triggers, and assumptions for periodic stress tests are established and approved. The size of the limit depends on the size of the balance sheet, depth of the market, the stability of the liabilities, and liquidity of the assets. Generally, limits are established such that in stressed scenarios, GIC could be self-funded.

The liquidity limits being monitored frequently include the following:

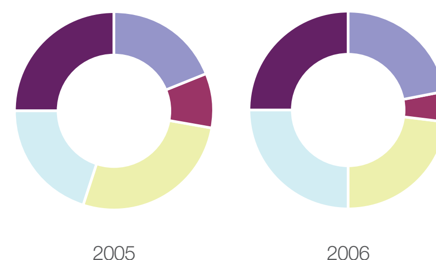
a) Maximum daily cash outflow limit for major currencies;
b) Maximum cumulative cash outflow which includes likely outflows as a result of draw-down of commitments, etc; and
c) Net liquid asset ratio – this ratio is calculated by taking a conservative view of marketability of liquid assets, with a discount to cover price volatility and any drop in price in the event of a forced sale.

The net liquid asset ratio as at 31st December 2006 was 16.3%. The following criteria were considered in determining this particular ratio:

a) A 3-month remaining maturity is being used to establish the time threshold by which balance sheet items are determined to be liquid or illiquid, stable or volatile;
b) Appropriate 'haircuts' are applied on liquid assets to reflect the potential market discounts; and
c) A 'business as usual' posture is maintained in ascertaining the level of assets to be liquidated or pledged to avoid sending a wrong signal to the market.

Diversified Sources of Funding

	US$ 000s	2006 (US$)	2006 (%)	2005 (US$)	2005 (%)
	GCC Deposits	1,745	22%	1,405	19%
	International Deposits	387	5%	656	9%
	Repo Financing	1,836	23%	2,039	27%
	Term Financing	2,046	25%	1,500	20%
	Shareholder's funds and others	2,099	25%	1,845	25%
	Total	8,113	100.0%	7,445	100.0%



The Corporation's investment portfolios are managed so that holdings of unpledged, marketable securities that comprised the strategic reserve are equivalent to at least 50% of the projected maximum cumulative cash outflow. As at end of December 2006, investments in marketable securities were almost US$ 4.0bn, primarily made up of investment grade securities.

The quantities of pledged securities are reviewed periodically to ensure that the quantity of pledged securities does not exceed the amounts actually required to secure funding or for other purposes. Additionally, to the greatest extent possible, the selection of securities to be pledged is made in a manner whereby the longest term and/or least marketable securities are utilized.

Market Access for Liquidity

Effective liquidity management includes assessing market access and determining various funding options. Having said this, GIC deems it critical to maintain market confidence to attain the flexibility necessary to capitalize on opportunities for business expansion, and to protect the Corporation's capital base.

Proactive and prudent liquidity management requires a stable and diversified funding structure. To this end, GIC always maintains a well-balanced portfolio of liabilities in order to generate a stable flow of financing and to provide protection against sudden market disruptions. To the extent practical and consistent with other GIC objectives, the Corporation emphasizes both minimal reliance on short-term borrowed funds and also the use of intermediate and long-term borrowings in place of short-term funding.

A diversity of funding sources, currencies, and maturities is used to gain a broad access to the investor base. The corporation's deposit base at year-end 2006 stood in excess of US$ 2 billion, about 22% are due to GCC deposits which, over the years, had proven to be stable source of funds. Additional short term funding is acquired through the use of repurchase agreements secured by a portfolio of high-grade securities. Such form of funding accounted for 23% of total funding at year-end 2006.

Attesting to the GIC's ability to mobilize long-term funding are the two EMTN issues successfully realized during 2006. The first was in March 2006 for HK$ 150 million for a period of 5 years, and the second was in May 2006 for EUR 400 million, likewise to mature in 5 years. Both issues had shored-up term financing by about 36%, or more than US$ 500 million in absolute amount.

The chart and table above provides the breakdown of the Corporation's funding source for the comparative years 2005 and 2006.

Contingency Funding Plan

Within GIC, liquidity is managed through a well-defined process to ensure that all funding requirements will be met properly. This process includes establishment of an appropriate contingency funding plan (CFP).

GIC's CFP prepares the Corporation for the unlikely event of a liquidity crisis caused by material changes in the

Risk Management continued

financial market conditions, including credit rating downgrades. CFP procedures are articulated clearly in the Corporation's Liquidity Policy Document. The procedures include:

a) a variety of measures to be undertaken in the absence of liquidity crisis to enhance GIC's available liquidity in the event of a crisis;
b) specific triggers that will prompt activation of CFP; and
c) specific guidelines for the management of liquidity crisis.

Interest Rate Risk Gapping Limit

Treasury manages short-term interest rate gapping by means of monitoring overall interest rate exposure in the next 24 months as measured in Eurodollar futures contract equivalents. It is widely accepted that the rate calculated from short-dated (up to two years) Eurodollar futures contract is effectively the forward interest rate of the underlying. Any funding, placements or borrowing that has a maturity or re-pricing of over two years are either matched or hedged.

Since GIC also runs gapping positions in other major currencies apart from the USD, the gaps on these currency positions are translated to USD equivalents in order to ascertain the equivalent number of Eurodollar futures contract.

The Eurodollar futures contract, given its liquidity, is a reasonable proxy to gauge interest rate risk on the short-term funding gap. The rationale behind this type of measurement is, if necessary, that positive (negative) gaps within a given time bucket could be covered by selling (buying) Eurodollar futures contracts equivalent to the notional amount of the gaps. Potential contracts from individual time buckets are accumulated for each currency and then subsequently aggregated for all major currencies. The maximum number of notional contract is currently set at 3,500.

Treasury is responsible for monitoring and ensuring that potential short-term interest rate risk exposure remains within the authorized limits. Proper escalation procedures are in place to address temporary and permanent excesses.

Maturity Profile of Assets and Liabilities

A detailed breakdown of the maturity profile by individual asset and liability category is provided in Note 25 to financial statements. At 31 December 2006, roughly 19.2% of total assets were due to mature within 12 months. Approximately 75.3% of assets with longer maturities were readily realizable securities. The maturity profile is based on contractual repayment arrangements and as such does not take account of effective maturities of deposits. The corporation's GCC retention record shows that short maturity deposits from GCC governments, central banks and other regional financial institutions have been regularly renewed over the past several years.

Credit Rating

Reaffirming GIC's premier position in the region, Fitch Ratings assigned a long term IDR of A and a short term rating of F1, with a stable outlook for both. The Fitch report highlighted the Corporation's strong capitalization, consistent profitability, cost efficiency and good franchise in GCC private equity investments. GIC continues to be rated A- by Standard & Poor's and A2 by Moody's. GIC is among a select few financial institutions in the region to maintain such high ratings by all three major international agencies. The superior ratings reflect, among other strengths, the Corporation's consistently strong track record, ownership and effective management.

The corporation's enhanced rating is indicative of a sound business operation and future business potential.

Capital Strength

Capital represents the shareholders' investment and is a key strategic resource which supports the Corporation's risk taking business activities. In line with the Corporation's financial objective, management strives to deploy this resource in an efficient and disciplined manner to earn competitive returns. Capital also reflects financial strength and security to the Corporation's creditors and depositors. Capital management is fundamental to GIC's risk management philosophy, and takes into account economic and regulatory requirements.

Credit ratings

	Moody's	Standard & Poor's	Fitch
Long-term Deposits	A2	A-	A
Short-term Deposits	P1	A2	F1
Bank Financial Strength (BFSR)	D+	-	-

Regulatory Capital

The Basel Committee on Banking Supervision has introduced a revised capital adequacy framework that promotes the adoption of stronger risk management practices, and more risk-sensitive capital requirements that are conceptually sound and at the same time pay due regard to particular features of the present supervisory and accounting systems in individual member countries.

The Central Bank of Kuwait (CBK) had issued a directive for banks in Kuwait to implement the revised accord beginning December 2005. While GIC does not fall under the purview of the CBK, the Corporation finds it prudent to implement the recommendations set forth under the revised accord with the following primary objectives:

a) The corporation has been subjecting itself to the standards of Basel 1 (1988) and the amendments introduced in 1998 (market risk). As a natural progression, adoption of the modified standards as outlined in the revised capital accord underscores the Corporation's commitment to be in line with international standards;
b) GIC acknowledges the importance of the qualitative and quantitative approaches set out in Basel 2 that impose rigor and discipline with respect to capital adequacy assessment; and
c) Adopting the Basel 2 capital accord is viewed to enhance risk culture within the organization and further strengthen GIC's market image, thus, resulting in improvements in external credit ratings assigned by international rating agencies, thereby ensuring continued access to capital markets.

Under the new accord, the Corporation's Total and Tier 1 capital ratios at the end of December 2006 are 21.73% and 20.57%, respectively. The structured standardized approach was used to calculate the capital requirement to cover credit and operational risks. Market risk capital cover calculation, on the other hand, employed the VaR-based approach. Going forward, GIC aims to achieve convergence of regulatory capital with economic capital as it adopts more advanced measurements for capital adequacy.

Risk Management
continued

Economic Capital

In addition to maintaining capital reserves based on regulatory requirements, economic capital sufficiency based on internal models is also determined. The economic capital computation process has three fundamental objectives: determine economic capital sufficiency, in addition to regulatory capital adequacy; assist in equitable/standardized performance measurement of businesses, on a 'real' (risk adjusted) basis; and assist in optimizing resource allocation to achieve target risk adjusted ROE for the Corporation.

Economic capital is a measure of risk and can be defined as the amount of capital required to cover unexpected losses, arising from doing business. It is the amount of capital that is required to achieve equilibrium between expected return and risk of bankruptcy. The need for economic capital arises due to the uncertainty of positive returns and or future cash flows. For each asset/exposure, portfolio, business unit, group and entity, economic capital reflects the quantification of the unexpected loss amounts arising from the four principal risk forms: Credit risk, Market risk, Liquidity risk and Operational risk.

Operational Risk

The introduction and implementation of the new accord transcends operational risk management into a serious emerging issue for the regulators and financial institutions alike. Operational risk is defined by GIC as the risk of loss to earnings or capital arising from inadequate or failed internal processes, people or systems or from external events. This definition clearly includes disaster recovery planning as another element of operational risk management. It is for this reason that the Corporation finds it prudent to include the same consideration – namely, unexpected significant and unusual one-time events, such as disaster events – in its framework for operational risk management.

GIC already has a strong internal control culture and a good information system that assist in the timely identification and resolution of material operational risks. There are existing policies and procedures that address operational risk issues relating to procedures and systems controls. Among these controls are:

a) appropriate segregation of duties by adopting the 'checker-maker' concept in operating procedures;
b) the scheduled reconciliation processes to identify unusual items;
c) the implementation of system security controls;
d) periodic internal audit due diligence to verify that operating policies and procedures have been implemented effectively;
e) suitable insurance coverage remains valid to mitigate operational losses; and
f) the formulation of a comprehensive Disaster Recovery Plan (DRP) and Business Continuity Plans (BCPs).

Since the Corporation plans to graduate to a more advance level (the Advance Measurement Approach or AMA) in calculating operational risk capital requirement, a more disciplined 'bottom-up' method will be adopted whereby the approach is anchored on objective loss data. To implement such an approach, a four-stage progression will be followed:

Stage 1
Operational Risk Self Assessment (ORSA).

This will involve qualitative review of inherent operational risks, assessment of controls and procedures, and specification of corrective actions if necessary and follow-up on implementation of such actions.

The self-assessment process involves line management in each business and operating unit that allows for comfortable participation and frank open communication between the line managers and the operational risk managers. ORSA is likewise seen to train line managers to consciously be aware of potential operational risks that may occur in their respective areas of responsibilities.

Stage 2
Identification and Loss Data Collection.

This will entail mapping out the risk inherent in the business that must be consistent with the scope of operational risk defined under the revised capital accord (Basel 2). The internal losses will be tracked in accordance with the seven (7) loss event types criteria set out by Basel 2, namely:

a) internal fraud
b) external fraud
c) execution, delivery and process management
d) clients, products, and business practices
e) employment practices and workplace safety
f) business disruptions and failures
g) damage to physical assets

Stage 3
Developing Metrics and Key Risk Indicators (KRIs).

Developing KRIs is the process of collecting and reporting on an eclectic set of quantitative measures that correlate with the likelihood of potential failures in a process. KRIs will be examined in combination with loss data.

Stage 4
Measurement or Analytics.

Analytics relates to quantitative analysis applicable to fragmentary data of very low probability but very high impact loss events. The aim at this level is to allow GIC to manage operational risk and measure internally the capital requirement, compliant with the Advanced Measurement Approaches (AMA) recommended by Basel 2. In general, the objective is to estimate a loss distribution and to derive functions of interest from it, such as value-at-risk (VaR).

Throughout the four stages, results will be consolidated and the ORM process will be continuously improved. This qualitative to quantitative approach to operational risk may take some time, but the immediate benefits derived in terms of ORM improvement and better operational risk awareness will be worth the exercise.

Basel 2 Disclosure

Basel 2 Rationale: Aligning banking risks management with capital requirements

As Basel 2 continues to evolve, the Basel Committee moves closer to its goal of aligning banking risk and its management with capital requirements. The primary objective of the new accord is to improve safety and soundness in the financial system by placing increased emphasis on bank's internal controls and risk management processes and models, the supervisory review process, and market discipline.

While the 1988 Capital Accord addressed market and credit risks, Basel 2 substantially changes the treatment of credit risk and also requires that banks have sufficient capital to cover operational risk. Compliance to the accord requires gathering extensive data in order to implement a comprehensive risk framework across the institution. As such, this would likely have wide-ranging effects on a bank's information technology, processes, people and business – beyond regulatory compliance and finance functions.

Basel 2 also encourages ongoing improvements in risk assessments and mitigation. Thus, over time, it presents banks with the opportunity to gain competitive advantage by allocating capital to business activities that demonstrate a strong risk-return ratio. Developing a better understanding of the risk/reward trade-off for capital supporting specific business or products is one of the most important business benefits banks may derive from compliance to the new accord.

The Architecture of Basel 2 – The Three Pillars

With Basel 2, the Basel Committee abandons Basel 1's 'one-size-fits-all' method of calculating minimum regulatory capital requirements and introduced a three-pillar concept that seeks to align regulatory requirements with economic principles of risk management. At the same time, by putting operational risk management on every bank's agenda, Basel 2 encourages a new focus on its management and sound and comprehensive corporate governance practices.

The Three Pillars Defined…

Pillar 1 – Minimum Capital Requirements

Pillar 1 sets out minimum regulatory capital requirements – meaning the amount of capital banks must hold against risks. The new framework provides a continuum of approaches from basic to advanced methodologies for the measurement of both credit and operational risks. It provides a flexible structure in which banks, subject to supervisory review, will adopt approaches that best fit their level of sophistication and their risk profile. The framework also deliberately builds in rewards for stronger and more accurate risk measurement.

Pillar 2 – Supervisory Review

Pillar 2 defines the process for supervisory review of a bank's risk management framework and ultimately, its capital adequacy. It sets out specific oversight responsibilities for the board and senior management, thus reinforcing principles of internal controls and corporate governance practices.

Financial supervisors would be responsible for evaluating how well banks are assessing their capital adequacy needs relative to their risks. Intervention would be exercised, where appropriate.

Pillar 3 – Market Discipline

Pillar 3 aims to bolster market discipline through enhanced disclosure by banks. It sets out disclosure requirements and recommendations in several areas, including the way a bank calculates its capital adequacy and its risks assessment methods. The intended result is enhanced transparency and comparability with other banks.

Gulf Investment Corporation G.S.C. (GIC or 'the Corporation') – Market Disclosure

The following sections set out the Corporation's disclosure details prepared in line with the new accord's requirements vide its publication dated June 2006 – A Revised Framework for International Convergence of Capital Measurement and Capital Standard.

1. Capital Structure

GIC is an investment company incorporated in the State of Kuwait on November 15,1983 as a Gulf Shareholding Company. It is equally owned by the governments of the six member states of the Gulf Cooperation Council (GCC), i.e., Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

The corporation has no subsidiaries or significant investments in banking, insurance, securities, and other financial entities.

Table 1 presents the Corporation's regulatory capital resources for the years ending December 2006 and December 2005. In order to allow comparison for the two fiscal years in review, the 2005 capital structure is presented following the Basel 2 guidelines.

The definition of regulatory capital under the two accords remains unchanged. However, Basel 2 permits recognition of general provision (albeit subject to a maximum of 1.25% of credit risk weighted assets) as part of Tier 2 capital. Meanwhile, the portion of significant investments in financial and commercial entities that exceed a certain materiality threshold; and exposures to 'Securitization' that fall below a cut-off risk grade are deducted 50% from Tier 1 and 50% from Tier 2 capital, respectively.

Total eligible regulatory capital improved to USD1,544MM by year-end Dec 2006 from USD1,428MM recorded in Dec 2005. The growth was due in great part to higher Tier 1 capital, thanks to the improvements in retained earnings and reserves.

Tier 2 capital includes 45% of the fair value reserve for investment in projects, securities, funds and alternative assets. Notably, while the new accord is silent on the application of discounts on fair value reserve, GIC elected to apply the same level of discount (i.e. 55%) as contained in the guidelines set by the Central Bank of Kuwait. In keeping with the spirit of the accord, the Corporation feels strongly that application of a discount suggests the possibility of price fluctuations, and as such, a better reflection of the true risk positions.

Table 1: Eligible Regulatory Capital

In US$ millions	31 December 2006	31 December 2005
Paid-up capital	750.0	750.0
Disclosed reserves	403.3	283.3
Retained earnings (post dividends)	348.1	281.5
Less: Goodwill	39.5	36.3
Deductions	0.2	0.5
Total Tier 1 Capital	1,461.7	1,278.0
Fair value reserve (45%)	78.2	147.4
General Provision	4.6	3.5
Less: Deductions	0.2	0.5
Total Tier 2 Capital	82.6	150.4
Total eligible regulatory capital	1,544.3	1,428.4

2. Capital Adequacy Management

The corporation's primary guiding principle to its capital adequacy management is to maintain a strong capital base that could support current as well as future growth in business activities, and at the same time, with the objective of maintaining satisfactory capital ratios and high credit ratings.

GIC's process of assessing the capital requirements commences with the compilation of the annual business plan by individual business units which are then consolidated into the annual budget plan of the Corporation. The annual budget plan provides the estimated overall growth in assets, its impact on capital and targeted profitability for the forthcoming fiscal year.

Utilizing the financial projections generated from the budget plan, capital is allocated to the various business units in such a way that the allocations remain consistent with the risk profile of the business activity. These capital allocations as well as corresponding RORACs (return on risk-adjusted capital) are reviewed on an ongoing basis during the budget year in order to optimally deploy capital to achieve targeted returns.

Whilst the Corporation acknowledges the benefits of higher leverage to ROE (Return on Equity), it also believes in the advantage and benefit of keeping a strong capital position. As such, GIC maintains a prudent balance among the major components of its capital. Current internal policy aims to maintain a floor of 16% total capital adequacy ratio.

Annual dividend payout, meanwhile, is prudently determined and proposed by the Board of Directors, endeavoring to meet shareholder expectations while ensuring adequate retention of capital to support organic growth.

Finally, the Corporation targets a credit risk rating of single 'A' or better. This would allow easy access to capital from the market at competitive pricing in the event additional funding needs to be appropriated. Moody's and Fitch

Basel 2 Disclosure continued

Table 2: Capital Adequacy Ratios

In US$ millions	Risk-weighted assets	Capital requirement
Credit Risk	4,655.2	372.4
Market Risk	1,672.2	133.8
Operational Risk	779.8	62.4
Total	7,107.2	568.6
Capital Adequacy Ratios (%)		
Total CAR	21.73%	
Tier 1 Ratio	20.57	

Table 3: Risk Exposure Break-down

In US$ millions	31 December 2006
Credit Risk (RWA)	
Claims on sovereigns	172.1
Caims on Public Sector Entities	110.7
Claims on Banks	865.2
Claims on Corporates	1,148.1
Securitization and Structured Investment Vehicle	581.3
Venture Capital and Private Equity	225.1
Investments in Commercial Entities	1,025.7
Investments in Other Funds and Quoted Equities	299.3
Other Assets	427.7
Total	4,655.2
Market Risk (VaR)	
Interest rate risk position	1.0
Foreign exchange risk position	0.5
Equity risk position	15.4
Total VaR x 3	50.5
Specific risk position	83.3
Total capital requirement	133.8
Total RWA (capital requirement x 12.5)	1,672.2
Operational Risk (RWA):	
Operational risk capital charge	62.4
Total RWA (capital charge x 12.5)	779.8

have recently affirmed their 'A2' and 'A' ratings, respectively. Standard and Poor's accorded an 'A-' rating to GIC. All three international rating agencies conferred a 'stable' outlook for all their ratings.

Table 2 details the risk-weighted assets together with their corresponding regulatory capital requirements as at 31 Dec 2006. Total capital adequacy ratio and Tier 1 capital ratio are likewise calculated. The numbers were generated by applying the 'Standardized' approach for credit and operational risks, while the 'Internal Model' approach was utilized to yield market risk positions.

Total risk-weighted exposures of USD 7,107MM as at end of Dec 2006 requires regulatory capital of USD 569MM to meet the minimum Basel 2 CAR of 8%. Should the minimum CAR threshold be raised to GIC's internal target of 16%, the required regulatory capital increases to about USD 1,137MM. The reported eligible regulatory capital of USD 1,580MM still provides sufficient cushion to support business expansions.

3. Risk Management Structure

To address the continuously changing and complex business environment, the Corporation adapts an agile and effective risk management process. Management realizes that not all risks needs to be eliminated; however, they need to be systematically identified and measured in order to be properly managed. To this end, the Corporation established an effective risk management structure that enabled a process of achieving an appropriate balance between risk and reward, by optimizing profits and ensuring that GIC is protected from unwarranted exposures that are likely to threaten the viability of the Corporation.

The corporation's risk management process is an integral part of the organization's culture, and is embedded into the organization's practices as well as in all those involved in the risk management process. The Executive Committee (Execom) of the Board, senior management, risk officers, and line managers contribute to effective enterprise-wide risk management. The Execom defines its expectations, and through its oversight determines its accomplishment. The Board of Directors has ultimate responsibility for risk management as they set the tone and other components of an enterprise risk management. Risk officers have the responsibility for monitoring progress and for assisting line managers in reporting relevant risk information and the line managers are directly responsible for all business risk generated in their respective domains. The effective relationship between these parties significantly contributes to the improvement in the Corporation's overall risk management practices as this leads to the timely identification of risk and facilitation of appropriate response.

The Risk Management Division (RMD) structure has a distinct identity and independence from business units. RMD ensures that risk exposures remain within tolerable levels relative to the Corporation's capital and financial position. The division reports directly to the Chief Executive Officer & General Manager, and is manned by dedicated risk specialists in all disciplines to address the pertinent business risks exposure of the Corporation. Its main responsibilities are to:

a) Evaluate and analyze the enterprise-wide risk profile by developing risk monitoring techniques;
b) Set up and develop criteria for defining the Corporation's risk threshold in terms of various risk;
c) Develop and establish tools for the measurement of the Corporation's various risk types; and
d) Recommend appropriate strategies/actions for mitigating risk and ensuring a sound risk asset structure for the Corporation.

The abridged organizational structure of GIC's risk management structure is shown below:

The following management committees have the responsibility and authority for the day-to-day risk management activities of the Corporation, and whereby such authorities are being exercised within the objectives and policies approved by the Executive Committee.

a) Management Committee (Mancom) covers mainly general management issues including performance review vis-à-vis budget, and assessment of status quo against strategic business plan.
b) GMG Investment Committee translates investment strategy directions into asset allocation guidelines, recommends investment proposals, and reviews investment portfolios. The committee also functions as a surrogate Asset-Liability Committee.
c) PI Investment Committee evaluates proposals for investments and divestiture of assets. Ensures compliance to investment criteria as well as investment procedures at each phase of the investment process.
d) GM Product Management Committee identifies product development opportunities, recommends product launches, and monitors performance of same. Product performance and operational issues are resolved in this committee.
e) Systems Steering Committee provides the forum to discuss and approve IT requirements and technical issues affecting end-users and support functions. The committee likewise reviews the IT architecture and its condition to meet current and future business requirements.
f) Audit Committee provides assurance on the adequacy of internal controls and accuracy of reports and reporting.
g) Human Resources Committee, as it relates to risk, covers the staffing levels and succession planning, as well as review of performance and bonus determination.

The risk management objectives, policies, measurement and reporting for the major risk areas, i.e., credit, market, liquidity, operational, interest rate risk are detailed in the 'Risk Management' section. The same section provides for the approach adopted by the Corporation towards management and mitigation of these risks.

Basel 2 Disclosure continued

4. Credit Risk Exposure

The corporation follows both qualitative and quantitative approaches to credit risk management. These approaches are clearly articulated in the Corporation's Credit Policy Document which aims to promote a strong credit risk management architecture that includes credit procedures and processes. The policy defines the areas and scope of investment activities undertaken by the Corporation and its main goal is not simply to avoid losses, but to ensure achievement of targeted financial results with a high degree of reliability. The corporation's credit risk management focuses on the dynamic and interactive relationship between three credit process phases: Portfolio strategy and planning, investment origination and maintenance, and performance assessment and reporting. Each of these phases is discussed briefly below.

Portfolio Strategy and Planning

The overall desired financial results, the portfolio strategy of each business unit, and the credit standards required to achieve the targets are defined during the planning phase. The business strategies are developed in such a way that they integrate risk and that they meet the defined hurdles in terms of return on risk-adjusted capital (RORAC).

Portfolio management establishes composition targets, monitors the results of these diverse business strategies on a continual basis, and allows the Corporation to manage concentrations that can result from seemingly unrelated activities. Specifically, portfolio management involves setting concentration limits by standard dimensions so that no one category of assets or dimension of risk can materially harm the overall performance of the Corporation.

The Board has set specific limits for individual borrowers and groups of borrowers and for geographical and industry segments. These limits consider the individual credit of the various counterparties as well as the overall portfolio risk.

The Investment Committees approve investment proposals and review portfolio concentrations in terms of economic sectors and asset class. These limits are reviewed annually to ensure that there are no undue concentrations in one sector or asset class, and that the limits are within those set out by the Corporation.

For counter-party limits, such as limits for banks and financial institutions, credit line approval follows a strict process of credit review, with proper authority levels delegated to senior credit officers.

Foreign exchange trading and interest rate gap limits, together with ancillary limits (e.g., daylight, overnight, stop loss, etc.) are recommended by Treasury for the review of RMD, and eventual approval by the Executive Committee.

The Risk Management Division quantifies the Corporation's credit risk appetite in line with the overall strategy. The division employs a process of allocating capital on a portfolio level for the total credit exposure assumed by each business unit. The business units' actual capital consumption is assessed against the budget, and variances are appropriately reported to senior management.

Investment Origination and Maintenance

The business units solicit, evaluate, and manage credit exposure according to the strategies and portfolio parameters established during the portfolio strategy and planning phase. Investments are generated within well-defined criteria, product structure, and are approved on the basis of risk and return assessment.

The processes involved under credit maintenance include documentation review and disbursement, and review of the status of exposures. Within this phase, origination and underwriting for distribution to investors takes place. The business units remain the sponsor and main risk managers of their proposals. While the risk management team independently reviews investment/product proposals prior to granting approvals to ensure that the proposals are within the tolerable risk appetite of the Corporation and are consistent with its policy, prior to disbursement of funds.

Performance Assessment and Reporting

The performance assessment and reporting phase allows both the Senior Management and business units to monitor results and improve performance continually. Both portfolio and process trends are monitored in order to make appropriate and timely adjustments to business strategies, portfolio parameters, credit policies and investment origination and maintenance practices. This phase of the credit process draws on information within the Corporation and external benchmarks to help evaluate performance.

The goal of performance assessment is to achieve a balanced portfolio of assets, well diversified, and generating returns consistent with targets. Credit performance is assessed through analysis of:

a) Portfolio concentrations by obligor, industry, risk rating, maturity, asset class, as well as other dimensions;
b) Generated return on capital employed (RORAC);
c) Additional economic value created by individual projects;
d) Exceptions to risk acceptance criteria; and
e) Other policy exceptions.

Inherent in the Corporation's business activity is the presence of 'portfolio risk', which arises whenever there is high positive correlation between individual credit portfolios. To address this particular risk, the Corporation employs the 'Credit Manager' system promoted by the Risk Metrics Group. The system is a quantitative based program where overall portfolio 'Credit Value at Risk' is measured and controlled. This model calculates Credit VAR based on credit ratings of the names, default probabilities, loss given default, current market prices of the credits, while considering the impact of correlation of the various credits in the portfolio.

In order to institute a common language for understanding and dimensioning credit risk across GIC's range of investments in projects, RMD is in the process of developing an internal credit risk rating (ICRR) model that would assist management in determining level of capital allocation and other strategic-schemes applicable to the investment credit rating. Naturally, the model will also be used to benchmark the required return given a particular level of risk. Additionally, the rating results will subsequently be used as valuable inputs into the 'Credit Manager' system mentioned above.

Credit Risk as per Basel 2 Standardized Approach

Under the credit risk 'Standardized' approach, credit exposures are categorized to standard portfolios that are subject to a distinctive risk-weighting scale based on standard characteristics of the nature of borrower as well as the external credit assessments of international rating agencies where available. GIC uses the credit ratings assigned by Moody's, S&P's and Fitch for this purpose. When more than one counter-party rating is available, Basel 2's multiple assessment guidelines are invoked.

In order to provide a common platform into which different notations used by the aforementioned rating agencies can be mapped, a scale of uniform Credit Quality Grades (CQG) represented by the numerals 1 to 5 or 6 are used to represent the relevant risk weights of each standard portfolio. Separate scales are prepared for risk-weighting both long-and short-term issues. Table 4 serves as a sample of mapping notations of rating agencies into CQGs for claims on Corporates.

As at December 31,2006, rated credit exposures accounted for more than 50% of total credit exposures. Note that the numbers are after applying the equivalent risk-weights (credit conversion) as provided under the Basel 2 accord. Meanwhile, gross credit exposure to rated assets was recorded at 70% of total gross credit exposure. Assets that are rated single 'A' or better comprised 55% of rated gross credit exposure. Tables 5 and 6 present the breakdown of credit exposures pre- and post-credit conversion.

In terms of facility type (Table 7), USD6,838MM (96%) is funded. The remaining balance is ascribed to guarantees issued and commitments made by the Corporation, as well as credit exposures on outstanding forward and swap transactions with banks.

The geographical distribution (Table 8) is based on either the primary purpose of the exposure or the place of incorporation of the debt security issuer, or incorporation of fund manager. A sizable portion of credit exposure is in the GCC region tallying at USD 2,962MM, or 42% of the total. Following suit are exposures to Europe and North America, 37% and 19% respectively. These exposures are due in great part to investments in global securities and funds with varying investment themes.

Basel 2 Disclosure
continued

Table 4: CQG Mapping

Corporates Credit Quality Grades	S & P	Moody's	Fitch
1	AAA	Aaa	AAA
	AA+	Aa1	AA+
	AA	Aa2	AA
	AA-	Aa3	AA-
2	A+	A1	A+
	A	A2	A
	A-	A3	A-
3	BBB+	Baa1	BBB+
	BBB	Baa2	BBB
	BBB-	Baa3	BBB-
4	BB+	Ba1	BB+
	BB	Ba2	BB
	BB-	Ba3	BB-
5	B+	B1	B+
	B	B2	B
	B-	B3	B-
6	CCC+	Caa1	CCC+
	CCC	Caa2	CCC
	CCC-	Caa3	CCC-
	CC	Ca	CC
	C	C	C
	D		D

Table 5: Credit Exposure (post-credit conversion)

In US$ millions	31 Dec 2006		
	Rated	Unrated	Total
Claims on Sovereigns	69.2	102.9	172.1
Caims on Public Sector Entities	80.7	30.0	110.7
Claims on Banks	865.2	-	865.2
Claims on Corporates	881.4	266.7	1,148.1
Securitization and SIVs	581.3	-	581.3
Venture Capital and Private Equity	-	225.1	225.1
Investments in Commercial Entities	-	1,025.7	1,025.7
Other Funds and Quoted Equities	-	299.3	299.3
Other Assets	-	227.7	227.7
Total	2,477.8	2,177.4	4,655.2
In Percent	53%	47%	100%

Table 6: Gross Credit Exposure (pre-credit conversion)

In US$ millions	31 Dec 2006		
	Rated	Unrated	Total
Claims on Sovereigns	395.9	102.9	498.8
Caims on Public Sector Entities	262.9	30.0	292.9
Claims on Banks	1,836.8	-	1,836.8
Claims on Corporates	1,665.9	266.7	1,932.6
Securitization and SIVs	788.8	-	788.8
Venture Capital and Private Equity	-	225.1	225.1
Investments in Commercial Entities	-	1,025.7	1,025.7
Other Funds and Quoted Equities	-	299.3	299.3
Other Assets	-	227.7	227.7
Total	4,950.3	2,177.4	7,127.7
In Percent	70%	30%	100%

Table 7: Gross Credit Exposure before CRM

In US$ millions	31 Dec 2006		
	Funded	Unfunded	Total
Claims on Sovereigns	498.8	-	498.8
Caims on Public Sector Entities	292.9	-	292.9
Claims on Banks	1,773.0	63.8	1,836.8
Claims on Corporates	1,707.5	225.1	1,932.6
Securitization and SIVs	788.8	-	788.8
Venture Capital and Private Equity	225.1	-	225.1
Investments in Commercial Entities	1,025.7	-	1,025.7
Other Funds and Quoted Equities	299.3	-	299.3
Other Assets	277.7	-	227.7
Total	6,838.8	288.9	7,127.7
In Percent	96%	4%	100%

Table 8: Gross Credit Exposure by Geographic Distribution

In US$ millions	31 Dec 2006					
	GCC	Other MENA	Europe	North America	Asia	Total
Claims on Sovereigns	332.1	102.9	23.7	15.0	25.1	498.8
Caims on Public Sector Entities	141.0	-	-	151.9	-	292.9
Claims on Banks	926.2	-	685.6	192.3	32.7	1,836.8
Claims on Corporates	127.7	-	1,276.9	508.0	20.0	1,932.6
Securitization and SIVs	-	-	533.8	255.0	-	788.8
Venture Capital and Private Equity	7.0	-	49.5	165.3	3.3	225.1
Investments in Commercial Entities	1,025.7	-	-	-	-	1,025.7
Other Funds and Quoted Equities	299.3	-	-	-	-	299.3
Other Assets	103.3	4.3	35.7	82.2	2.2	227.7
Total	2,962.3	107.2	2,605.2	1,369.7	83.2	7,127.7
In Percent	41.6%	1.5%	36.6%	19.2%	1.2%	100%

Basel 2 Disclosure
continued

Table 9: Gross Credit Exposure by Industry Sector

In US$ millions	31 Dec 2006					
	Banks & FIs	Trading & Mftg.	Utilities	Govt. & Agencies	Other	Total
Claims on Sovereigns	-	-	-	498.8	-	498.8
Caims on Public Sector Entities	-	-	-	292.9	-	292.9
Claims on Banks	1,836.8	-	-	-	-	1,836.8
Claims on Corporates	1,637.9	251.4	4.4	-	38.9	1,932.6
Securitization and SIVs	788.8	-	-	-	-	788.8
Venture Capital and Private Equity	225.1	-	-	-	-	225.1
Investments in Commercial Entities	50.5	878.5	80.2	-	16.5	1,025.7
Other Funds and Quoted Equities	299.3	-	-	-	-	299.3
Other Assets	64.8	-	-	15.2	147.7	227.7
Total	4,903.2	1,129.9	84.6	806.9	203.1	7,127.7
In Percent	68.8%	15.9%	1.2%	11.3%	2.8%	100%

Table 10: Credit Exposure by Residual Contractual Maturity

In US$ millions	31 Dec 2006				
	Within 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
Claims on Sovereigns	15.0	73.8	307.1	102.9	498.8
Caims on Public Sector Entities	-	-	201.7	91.2	292.9
Claims on Banks	259.4	526.7	859.4	191.3	1,836.8
Claims on Corporates	48.0	203.3	744.9	936.4	1,932.6
Securitization and SIVs	12.5	5.0	412.3	359.0	788.8
Venture Capital and Private Equity	12.1	5.9	50.0	157.1	224.1
Investments in Commercial Entities	-	204.3	-	821.4	1,025.7
Other Funds and Quoted Equities	-	-	-	299.3	299.3
Other Assets	121.1	43.5	2.8	60.3	227.7
Total	468.1	1,062.5	2,578.2	3,018.9	7,127.7
In Percent	6.6%	14.9%	36.2%	42.4%	100%

Table 11: Credit exposure on Securitization and SIVs

	31 Dec 2006	
In US$ millions	Gross exposure	Post-credit conversion
CQG 1	122.9	24.6
CQG 2	231.9	115.9
CQG 3	430.8	430.8
CQG 4	2.8	10.0
CQG 5	0.3	0.3
CQG 6	0	0
Unrated	0	0
Total	788.8	581.6

The table on industry distribution (Table 9) of the gross credit exposure reveals a concentration on banks and financial institutions, cornering 69% of total exposure. Again, this is traced to the Corporation's debt securities and fund investments as it diversifies its asset from purely equity holdings. Meanwhile, in line with GCC's commitment to support the industrial growth within the GCC region, equity investments in commercial entities are focused in the trading and manufacturing sectors.

The residual maturity of gross credit exposure broken down by standard credit risk exposure is shown in Table 10. A significant portion of credit exposure falls within the longest time bucket of over five years: 42%. Notably, an almost equal percentage of exposure, i.e., 37%, is spread within one to five years.

Recognition of Impairment of Assets

The corporation assesses at each balance sheet date whether there is any objective evidence that a financial asset is impaired. Investments are treated as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires considerable judgment. In addition, the Corporation evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for projects and unquoted equities.

The corporation reviews its problem loans and advances, and investment in debt instruments at each reporting date to assess whether a provision for impairment should be recorded in the statement of income. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

Noteworthy, the Corporation has taken a strategic decision to wind down its lending activities. An insignificant amount of impaired assets stemming from project loans provided to two manufacturing companies based in the GCC has been fully provided for.

5. Securitization Activities

The corporation's securitization exposure comes by way of its investments in structured products, which can be generally classified under synthetic securitization. Capital cover treatment of securitization exposures follows the 'Ratings Based' approach as recommended in the Basel 2 capital adequacy guidelines. As such, the external credit assessments provided by either Moody's or S&P are considered when determining credit risk weights for securitization exposures.

Table 11 provides the credit rating breakdown of the Corporation's investment in securitization and structured investment vehicles (SIVs):

Exposures that are rated CQG 5 and lower are deducted directly from regulatory capital.

6. Market Risk

Market risk is measured, monitored and managed, both on a notional basis, and using a Market Value at Risk (Market VaR) concept. Quantitative statistical methods combined with judgment and experience are used to effectively manage market risk. The VaR measure of market risk is computed separately for the 'Trading' portfolio, and the combined 'Trading' and 'Investment' portfolios. This section focuses on the VaR measurement for the 'Trading' book, specifically pertaining to regulatory capital adequacy computations. More details are provided in the Risk Management section of the annual report.

The regulatory capital adequacy ratios are computed incorporating capital charges for market risk, as per the 1996 Basel Committee amendment to the Capital Accord. GIC follows the Internal

Basel 2 Disclosure
continued

Models Approach (IMA) to quantify the capital charge associated with market risk within the trading portfolio.

The corporation uses the 'RiskManager' system, developed by Risk Metrics Group, that utilizes a parametric computational method based on the variance – covariance concept. The Value at Risk (VaR) system was first implemented in 1997, and was regularly upgraded over the years. In line with the capital accord, the parameters used in determining the VaR are a 10 day holding period and 99% confidence level. The computation utilizes an equally weighted historical data set going back one year. The computation ignores the correlation benefit amongst the three risk types (interest rate, equity and foreign exchange), with Total VaR (market risk) being equal to the arithmetic sum of the three components.

The capital charge relating to market risk is determined for all portfolios categorized as trading (the trading book), which includes the following (Ref Notes 4 and 5 of 2006 financial statements):

	US$ Millions
Trading Securities	233.1
Hedge & Alternative Funds Portfolio	597.5
Interest Bearing (Trading) Portfolio	397.3
	1,227.9

Policies relating to recognition, classification, fair value measurement and gain/loss computation are detailed in Note 2.6 of financial statements.

GIC believes that it is prudent to provide an explicit capital cushion for price risks to which it is exposed. Such risk of loss arising from the adverse changes in market variables is predominantly within the trading book. Within the Corporation, capital charge for market risk comprises three main categories: interest rate risk and equity risk (within the trading book) and foreign exchange risk for the entire Corporation.

The Value at Risk concept is a sound basis for the quantification of market risk, and the variance – co-variance methodology adequately suits the Corporation's asset types. Most of the exposures within the trading book entail very little optionality and are mostly linear in nature. The VaR based system provides a dynamic measure of market risk capturing, in a timely manner, the impact of changes in environment on the value of the portfolio of financial instruments.

The VaR model is a statistical tool, based on simplifying assumptions, and as such has certain limitations (examples: occurrence of 'fat tails', non-normal distributions and even risks; the past not being a good approximation of future, etc). To a large extent, these limitations are addressed by the back-testing exercise and related multiplication factor used.

For all the portfolios within the trading book, the same variance – co-variance methodology is used to compute VaR. VaR is computed on a daily basis as per the parameters described above.

Scenario analysis and stress testing is an essential component of the market risk management framework. The assumption of normality on which the statistical models are based may become invalid due to the occurrence of certain events. Future scenarios, which result in a breakdown of the historical behavior and relationships between risk constituents, are projected, and potential loss amounts are determined. Most of these scenarios are derived from macroeconomic events of the past, modified with the expectations for the future.

Back-testing

The objective of 'Back-testing' is to measure/validate the accuracy of the internal VaR model. Back-testing essentially deals with the process of comparing actual trading results with the model generated risk measures (estimates). Back-testing is conducted in line with the 'Supervisory Framework Document' issued by the Basel Committee. The parameters for back-testing are, a one-day holding period and 99% confidence level.

To the extent that the back-testing program is viewed purely as a statistical test of the integrity of the calculation of Value-at Risk (VaR) measure, the Corporation felt it appropriate to utilize the 'hypothetical portfolio' approach. In this approach, a static hypothetical model portfolio, with similar characteristics of the actual portfolio, is created and daily change in market value is computed based on actual price observations. VaR is also computed for this static portfolio using the model and comparisons are made between actual results and model estimates. The advantage of this method is that the value change outcomes are not 'contaminated' by changes in the portfolio (which could happen if the actual portfolio were used).

Based on the results of backtesting conducted, the VaR model and concept used to quantify market risk was found to be reasonably accurate, being categorized within the 'Green Zone'. As a result, a multiplication factor of 3 is used, in line with the Basel guidelines.

Capital charge for market risk is determined based on the following formula:

Capital Charge (market risk) = Max {V_{avg}, V_{end}} X Mf

Where,

V_{avg} equals:
Average Total VaR for the trading book over the previous 60 business days

V_{end} equals:
End of period Total VaR for the trading book

Mf equals:
Multiplication factor (a factor of three is used based on the results of back-testing)

7. Operational Risk

Operational risk is defined by GIC as the risk of direct and indirect loss resulting from inadequate or failed internal processes, people or systems or from external events. The corporation currently adopts the 'Standardized' approach in the estimation of regulatory capital to support potential operational risk exposure. This approach could be described as a 'bottom-up' method as it goes to the level of each business line within the Corporation.

In keeping with the Accord's guidelines, gross income for each business line is determined using the transfer pricing methodology being employed by the Corporation. The identified business lines as well as its major business segments are presented in Table 13.

The capital requirement for each business line and the corresponding capital charge are in Table 14.

The highest beta factor of 18% is applied on all business lines save for the 'Asset Management' business line, where a beta factor of 12% is used as suggested in the new capital accord.

Table 12: Trading Book VaR (US$ 000's) – 10 day holding period, 99% confidence level. For the period 9 October to 31 December 2006

In US$ millions	Interest Rate	Equity	FX	Total
Max	1.221	16.126	1.621	18.015
Min	0.536	15.018	0.110	16.162
Average	1.009	15.386	0.446	16.841
31 Dec 06	0.585	15.473	0.110	16.168

Table 13: Business Lines for Operational Risk

Business lines	Major business segments	Activity Groups
Principal Investments	Investment and Equity Participation	Venture Capital, Greenfield Investments, Mergers and Acquisitions, Privatizations, Equity Participation, IPOs, Secondary Private Placements
Debt Capital Markets	Investments of debt securities	International Corporate Securities, Sovereign Debts, GCC Issues/Bonds, Convertible Bonds, Islamic Bonds, ABSs, FRNs
Equity Investments	Portfolio of investments in equity funds and proprietary funds	Gulf Equities, Equity Portfolios
Alternative Investments	Portfolio of investments in an array of different asset classes and managed funds	Hedge Funds, SIVs, Real Estate, Structured Finance, Islamic Funds, Managed Funds, MBSs, Private Equity, Credit Funds
Treasury	Sales	Fixed Income, Equity, Foreign Exchanges, Commodities, Credit, Funding, Own Position Securities, Lending and Repos, Derivatives
	Market Making	
	Proprietary Positions	
Corporate Finance	Merchant Banking	Mergers and Acquisitions, Underwriting, Privatizations, Research, Debt (Government, High Yield), Syndications, IPO, Secondary Private Placements
	Advisory Services	
Asset Management	Discretionary Fund Management	Polled, Segregated, Retail, Institutional, Closed, Open
	Non-Discretionary Fund Management	Pooled, Segregated, Retail, Institution, Closed, Open
Head-quarters	Income classified for Head-quarters as per internal FTP (Fund Transfer Pricing) method, and other income that cannot be classified in any other business line	Income from Free Capital, Rental Income, Other Income, etc.

Basel 2 Disclosure
continued

The Corporation realizes that the accord offers a continuum of approaches from the simplest basic indicator approach to the more advanced measurement approaches. In its endeavor to adopt a more risk-sensitive approach to operational risk capital management, the Corporation plans to implement a more disciplined 'bottom-up' method whereby the approach is anchored on objective loss data. To implement such an approach, a four-stage progression will be followed:

Stage 1 – Operational Risk Self Assessment (ORSA).

Stage 2 – Identification and Loss Data Collection.

Stage 3 – Developing Metrics and Key Risk Indicators (KRIs).

Stage 4 – Measurement or Analytics.

Brief comments on each stage have been provided in the 'Risk Management' section of the annual report.

8. Equity Risk in the Banking Book

Equity investments in the banking book are classified at the time of acquisition into those acquired for realizing capital gains and to those purchased for strategic investments. The decision where to classify investments is arrived at after considering significant factors, that include business and strategic advantages to the Corporation, and the amount of planned investments. All investment decisions require the approval of the Investment Committees, or the Executive Committee, depending on the amount of exposure.

Investments acquired with a view to generating income and profits from capital appreciation are reviewed periodically and disposed off at opportune instances. Meanwhile, the strategic investment portfolios are reviewed based on the industry, market and economic developments, and the Corporation decides whether to liquidate or further consolidate its holdings in these investments.

In accordance with International Financial Reporting Standards, equity positions in the banking book are classified as available for sale securities. These investments are fair valued periodically and revaluation gains/losses are accounted as cumulative changes in fair value in equity. For equity investments quoted in organized financial markets, fair value is determined by reference to quoted bid prices. Fair values of unquoted equity investments are determined by reference to the market value of a similar investment, or the expected discounted cash flows, or other appropriate valuation models. Equity investments whose fair value cannot be estimated accurately are carried at cost less impairment, if any. More details on the accounting treatment of equity investments can be found under 'Significant Accounting Policies' in the financial statements section.

Publicly traded investments represent quoted equities traded in the local and international stock exchanges. Privately held investments represent investments in unquoted entities and projects. The total value of equity investments in the banking book at the end of December 2006 is USD 1,202MM, net of provision (refer to Table 15). Cumulative realized gain from sale or exchange of available for sale securities and projects is about USD 172MM, whereby a significant portion is from publicly traded equity holdings. Investments in projects that have market quotations contributed USD83MM, while privately held projects accounted for USD11MM. Meanwhile, the total un-realized gain recognized in equity is USD136.5MM, of which USD61MM is included in Tier 2 capital for capital adequacy calculation purposes.

9. Interest Rate Risk in the Banking Book

Treasury manages short term interest rate gapping by means of monitoring overall interest rate exposure in the next 24 months as measured in Eurodollar futures contract equivalents. Treasury is not allowed to mismatch positions over two years unless appropriate management approval has been obtained. Any funding, placements or borrowing that has a maturity or re-pricing profile of more than two years are either matched or hedged.

The rate calculated from short-dated (up to two years) Eurodollar futures contract is effectively the forward interest rate of the underlying, i.e. Eurodollar deposits. Total USD placements and borrowings transacted by Treasury are profiled in time buckets from one week and then monthly thereafter until 24 months. The same procedure is applied to other major currencies apart from the USD, the gaps on these currency positions are translated to USD equivalents in order to ascertain the equivalent number of Eurodollar futures contracts for the individual major currencies.

A maximum limit of 3,500 Eurodollar contracts is currently set, with the maximum VaR at USD2.8MM. The calculation of VaR equivalent is derived from the 90-day average of historical 30-day implied volatility of a rolling Eurodollar futures contracts yield. The current yield is adjusted by the average volatility before it is applied on the position value. The resulting number is then scaled up to a 95% level of confidence.

Table 14: Operational Risk Capital Charge

In US$ millions	31 Dec 2006		
	3 yr Average Gross Income	Beta Factor	Capital Charge
Principal Investment	160.7	18%	28.9
Debt Capital Market	42.8	18%	7.7
Equities Investments	21.2	18%	3.8
Alternative Investments	57.8	18%	10.4
Treasury	9.9	18%	1.8
Asset management	18.9	12%	2.3
Corporate Finance	0.8	18%	0.2
Head-quarters	40.8	18%	7.3
Total	352.9	-	62.4
Risk-weighted exposure			779.8

Table 15: Equity Holdings in Banking Book

In US$ millions	31 Dec 2006		
	Publicly Traded	Privately Held	Total
Fair Value of Equity Investments	623.4	578.1	1,201.5
Realized gains recorded in P/L	127.3	44.7	172.0
Unrealized gains recorded in equity	122.2	14.3	136.5
45% of unrealized gains in Tier 2 capital	55.0	6.4	61.4

The Eurodollar futures contract position value as at December 31,2006 is calculated at 1,023 contracts, with an estimated VaR of USD 0.264MM.

Proper escalation procedures are in place whenever set limits are breached, either on a temporary or permanent basis.

Strategic Partnerships

GIC increased its range of strategic relationships with some of the world's leading financial institutions. It has taken significant shareholding in Perella Weinberg, a new financial services firm that serves large global corporate clients.

Financial Statements

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Auditors' Report

to the Shareholders of Gulf Investment Corporation G.S.C

We have audited the accompanying financial statements of Gulf Investment Corporation G.S.C. ('the Corporation') which comprise the balance sheet as at December 31, 2006 and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

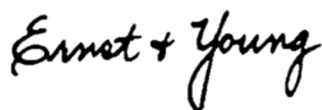
Opinion

In our opinion the financial statements present fairly, in all material respects, the financial position of the Corporation as of December 31, 2006 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait.

Report on other legal and regulatory requirements

Furthermore, in our opinion, proper books of account have been kept by the Corporation and the financial statements, together with the contents of the report of the Directors relating to these financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the financial statements incorporate all information that is required by the Commercial Companies Law of 1960, as amended, and by the Corporation's articles and memorandum of association, and that to the best of our knowledge and belief, no violations of the Commercial Companies Law of 1960, as amended, nor of the Corporation's articles and memorandum of association have occurred during the year ended December 31, 2006 that might have had a material effect on the business of the Corporation or on its financial position.

We further report that, during the course of our audit, we have not become aware of any material violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the Central Bank of Kuwait and the organization of banking business, and its related regulations during the year ended December 31, 2006.



ERNST & YOUNG
1 February 2007
KUWAIT

Balance Sheet

As at December 31, 2006

(US$ million)	Note	2006	2005
Assets			
Cash and cash equivalents		4.3	7.5
Placements	3	647.6	582.4
Securities purchased under resale agreements		13.7	24.6
Interest bearing securities and funds	4	4,746.3	4,460.8
Equities and managed funds	5	1,153.7	1,180.3
Loans	6	17.0	29.7
Receivable from shareholders	7	-	52.4
Private equity funds	8	226.5	184.2
Investment in project held for sale	9	198.4	-
Investment in projects and equity participations	10	878.5	736.2
Property and other fixed assets	11	20.4	21.9
Other assets	12	206.7	165.0
Total assets		8,113.1	7,445.0
Liabilities and equity			
Liabilities			
Deposits	13	2,131.4	2,061.1
Securities sold under repurchase agreements		1,836.0	2,039.4
Term finance	14	2,046.3	1,500.0
Other liabilities	15	188.2	202.3
Total liabilities		6,201.9	5,802.8
Equity			
Share capital		750.0	750.0
Reserves		576.9	610.7
Retained earnings		584.3	281.5
Total equity	16	1,911.2	1,642.2
Total liabilities and equity		8,113.1	7,445.0

The accompanying notes form an integral part of these financial statements.

Dr. Yousef Hamad Al-Ebraheem
Chairman

Hisham Abdulrazzaq Al-Razzuqi
Chief Executive Officer and General Manager

Statement of Income

For the year ended December 31, 2006

(US$ million)	Note	2006	2005
Interest and similar income	17	254.4	191.8
Investment and fee income	18	405.5	309.1
Gain on exchange of investment available for sale	19	170.4	-
Total income		830.3	500.9
Interest and similar expenses	20	(279.9)	(171.2)
Gross operating income		550.4	329.7
Income from recovery of debt	21	111.4	-
Provision for impairment losses	22	(5.5)	(11.4)
Staff cost		(34.3)	(28.2)
Premises cost		(3.5)	(2.6)
Other operating expense		(18.4)	(14.7)
Net income for the year		600.1	272.8

The accompanying notes form an integral part of these financial statements.

Statement of Changes in Equity

For the year ended December 31, 2006

(US$ million)	Share capital	Reserves: Compulsory reserve	Reserves: Voluntary reserve	Reserves: Investment revaluation reserve	Reserves: Subtotal reserves	Retained earnings	Total
Balance as at January 1, 2005	750.0	179.3	49.3	189.2	417.8	153.3	1,321.1
Net gains on disposal of investments available for sale transferred to statement of income	-	-	-	(90.7)	(90.7)	-	(90.7)
Change in fair value of investments available for sale	-	-	-	222.8	222.8	-	222.8
Share of investment revaluation reserves of associated companies	-	-	-	6.2	6.2	-	6.2
Total income and expenses for the year recognised directly in equity	-	-	-	138.3	138.3	-	138.3
Net income for the year	-	-	-	-	-	272.8	272.8
Total income for the year	-	-	-	138.3	138.3	272.8	411.1
Transfer to compulsory reserve	-	27.3	-	-	27.3	(27.3)	-
Transfer to voluntary reserve	-	-	27.3	-	27.3	(27.3)	-
Dividend for 2004 (note 24)	-	-	-	-	-	(90.0)	(90.0)
Balance as at December 31, 2005	750.0	206.6	76.6	327.5	610.7	281.5	1,642.2
Balance as at January 1, 2006	750.0	206.6	76.6	327.5	610.7	281.5	1,642.2
Net gains on disposal of investments available for sale transferred to statement of income	-	-	-	(128.5)	(128.5)	-	(128.5)
Change in fair value of investments available for sale	-	-	-	(26.3)	(26.3)	-	(26.3)
Share of investment revaluation reserves of associated companies	-	-	-	1.0	1.0	-	1.0
Total income and expenses for the year recognised directly in equity	-	-	-	(153.8)	(153.8)	-	(153.8)
Net income for the year	-	-	-	-	-	600.1	600.1
Total income for the year	-	-	-	(153.8)	(153.8)	600.1	446.3
Transfer to compulsory reserve	-	60.0	-	-	60.0	(60.0)	-
Transfer to voluntary reserve	-	-	60.0	-	60.0	(60.0)	-
Dividend for 2005 (note 24)	-	-	-	-	-	(177.3)	(177.3)
Balance as at December 31, 2006	750.0	266.6	136.6	173.7	576.9	584.3	1,911.2

The accompanying notes form an integral part of these financial statements.

Statement of Cash Flows

For the year ended December 31, 2006

(US$ million)	2006	2005
Cash flows from operating activities:		
Net income for the year	600.1	272.8
Adjustments for:		
Income receivable from the shareholders	(0.2)	(2.5)
Gain on exchange of investment available for sale	(170.4)	-
Income from recovery of debt	(111.4)	-
Provision for impairment losses	5.5	11.4
Net gain on sale of investment securities - available for sale	(57.6)	(47.2)
Net gain on sale of investment in projects and equity participations	(122.5)	(45.0)
Income from projects and equity participations	(75.1)	(88.4)
Amortisation of net premium/discount on interest bearing securities and funds	9.0	13.6
Depreciation	2.9	2.7
Increase in trading securities and investments carried at fair value through profit and loss	(98.8)	(533.1)
Increase in other assets and other liabilities (net)	(10.7)	(20.4)
Net cash outflow from operating activities	(29.2)	(436.1)
Cash flows from investing activities:		
Increase in placements	(65.0)	(24.5)
Decrease (increase) in securities purchased under resale agreements	10.9	(24.6)
Sale and maturity of investment securities	846.7	885.3
Purchase of investment securities	(932.7)	(303.7)
Decrease in loans	13.0	12.0
Increase in investment in private equity funds	(48.1)	(37.8)
Sale of investment in projects and equity participations	155.8	71.3
Increase in investment in projects and equity participations	(241.7)	(114.4)
Purchase of property and other fixed assets	(1.4)	(0.6)
Received from shareholders	52.6	144.4
Net cash (outflow) inflow from investing activities	(209.9)	607.4
Cash flows from financing activities:		
Increase (decrease) in deposits	70.3	(296.2)
Decrease in repurchase agreements	(203.4)	(488.3)
Increase in term finance	546.3	700.0
Dividend paid	(177.3)	(90.0)
Net cash inflow (outflow) from financing activities	235.9	(174.5)
Decrease in cash and cash equivalents	(3.2)	(3.2)
Cash and cash equivalents at beginning of year	7.5	10.7
Cash and cash equivalents at end of year	4.3	7.5

The accompanying notes form an integral part of these financial statements.

Notes to the Financial Statements

For the year ended December 31, 2006

1 INCORPORATION AND ACTIVITY

The Gulf Investment Corporation G.S.C. ("the Corporation") is an investment company incorporated in the State of Kuwait on November 15, 1983 as a Gulf Shareholding Company. It is equally owned by the governments of the six member states of the Gulf Co-operation Council ("GCC") – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. The corporation is engaged in all aspects of investment banking activities.

The corporation is domiciled in Kuwait and its registered office is at Jaber Al Mubarak Street, Al Sharq, Kuwait.

The financial statements were approved and authorised for issue by the Board of Directors on February 1, 2007. The General Assembly of Shareholders has the power to amend these financial statements after issuance.

2 SIGNIFICANT ACCOUNTING POLICIES

2.1 Statement of compliance

The financial statements of the Corporation have been prepared in accordance with the regulations of the government of the State of Kuwait for financial services institutions regulated by the Central Bank of Kuwait. These regulations require adoption of all International Financial Reporting Standards (IFRS) except for the IAS 39 requirement for collective provision, which has been replaced by the Central Bank of Kuwait's requirement for a minimum general provision as described under the accounting policy for impairment of financial assets. In addition, the financial statements have been prepared in accordance with the requirements of the Kuwait Commercial Companies Law of 1960, as amended, Ministerial Order No.18 of 1990 and the Corporation's memorandum and articles of association.

2.2 Basis of presentation

The corporation's functional and presentation currency is United States Dollars and the figures presented in the financial statements are in millions.

The financial statements are prepared on a fair value basis for derivative financial instruments, trading securities, financial assets at fair value through statement of income, available for sale assets and financial assets forming part of effective fair value hedging relationships, except those for which a reliable measure of fair value is not available. Other financial assets and liabilities and non-financial assets and liabilities are stated at amortised cost or historical cost.

The accounting policies have been consistently applied by the Corporation and are consistent with those used in the previous year.

2.3 Applicable IASB Standards and Interpretations issued but not adopted

The following IASB standards and interpretations have been issued but are not yet mandatory, and have not been adopted by the Corporation:

Amendment to IAS 1: Presentation of Financial Statements

IFRS 7: Financial Instruments: Disclosures

IFRIC Interpretation 9 Reassessment of Embedded Derivatives

IFRS 8: Operating Segments

Amendments to IAS 1 Presentation of Financial Statements were issued by the IASB as Capital Disclosures in August 2005. They are required to be applied for periods beginning on or after 1 January 2007. When effective, these amendments will require disclosure of information enabling evaluation of the Corporation's objectives, policies and processes for managing capital.

IFRS 7 Financial Instruments: Disclosure was issued by the IASB in August 2005, becoming effective for periods beginning on or after 1 January 2007. The new standard will require additional disclosure of the significance of financial instruments for the Corporation's financial position and performance and information about exposure to risks arising from financial instruments.

IFRIC 9 was issued in March 2006 and becomes effective for financial years beginning on or after 1 June 2006. This interpretation establishes that the date to assess the existence of an embedded derivative is the date an entity first becomes party to the contract with reassessment only if there is a change to the contract that significantly modifies the cash flows.

IFRS 8 was issued by the IASB in November 2006 and will be effective for annual periods beginning on or after 1 January 2009. Under the requirements of the standard, the Corporation would be required to disclose information used by management internally for the purpose of evaluating the performance of operating segments and allocating resources to those segments.

2.4 Subsidiaries

Subsidiaries are those enterprises controlled by the Corporation. Control exists when the Corporation has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The results of subsidiaries acquired or disposed during the year are included in the statement of income from the date of acquisition or up to the date of disposal, as appropriate. The financial statements of subsidiaries are prepared as at a reporting date within three months of the Corporation's accounting year end using consistent accounting policies.

Goodwill on acquisition is initially measured at cost being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities, and is included in the carrying value of the investment.

The investments in Bituminous Products Company Limited (Bitumat), GIC Technologies Company, Gulf Denim FZE, Investel Holdings W.L.L., Gulf Jyoti International, Crown Paper Mill Ltd. and Gulf Paramount for Electrical Services Company W.L.L., subsidiary companies, are not material to the financial statements of the Corporation. Accordingly, these subsidiaries are included under 'Investment in Projects and Equity Participations' (see note 10).

2.5 Cash and cash equivalents

Cash and cash equivalents comprise of cash in hand, balances with Central Banks and deposits with banks with maturities of less than seven days.

2.6 Financial Instruments

(i) Recognition

The corporation recognises purchases and sales of financial assets, with the exception of loans and receivables, on the trade date, i.e. the date that the Corporation commits to purchase or sell the asset.

Loans, receivables and deposits are recognised on the settlement date.

(ii) Classification

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics.

Investments carried at fair value through statement of income are financial assets for which fair value of the investment can be reliably measured and the classification as fair value through statement of income is as per the documented strategy of the Corporation.

Trading securities are those that the Corporation principally holds for the purpose of short-term profit taking.

Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the Corporation has the intent and ability to hold to maturity.

Loans and receivables are financial assets created by the Corporation providing money to a debtor other than those created with the intention of short-term profit taking.

Available-for-sale assets are financial assets that are not held for trading purposes, carried at fair value through statement of income, loans and receivables, or held-to-maturity. `

Issued financial instruments or their components are classified as liabilities where the substance of the contractual arrangement results in the Corporation having an obligation either to deliver cash or another financial asset to the holder.

(iii) Measurement
Financial instruments are initially measured at cost plus transaction costs except in the case of financial assets carried at fair value through the statement of income.

Subsequent to initial recognition all trading instruments, investments carried at fair value through statement of income and all available-for-sale assets are measured at fair value, except that any instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses (see note 2.17).

All non-trading financial liabilities, loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument.

After initial measurement, debt issued and other borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on the issue and fees that are an integral part of the effective interest rate.

(iv) Fair value measurement principles
The fair value of financial instruments is based on their quoted market price (bid price for assets and offer price for liabilities) at the balance sheet date without any deduction for transaction costs. If a quoted market price is not available then the fair value of the instrument is estimated using other valuation techniques as discussed in note 2.17.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate at the balance sheet date for an instrument with similar terms and conditions. Where pricing models are used, inputs are based on market related measures at the balance sheet date.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Corporation would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current credit worthiness of the counterparties.

(v) Gains and losses – subsequent measurement
Gains and losses arising from a change in the fair value of investments available for sale are recognised directly in equity. When the financial assets are sold, collected or otherwise disposed of, or determined to be impaired, the cumulative gain or loss recognised in equity is transferred to the statement of income.

Gains and losses arising from a change in the fair value of trading instruments and investments carried at fair value through the statement of income are recognised in the statement of income.

(vi) Offsetting
Financial assets and liabilities are offset and the net amount is reported in the balance sheet when the Corporation has a legally enforceable right to set off the recognised amounts and the transactions are intended to be settled on a net basis.

(vii) Derecognition

A financial asset (in whole or in part) is derecognised either (a) when the rights to the cash flow have expired, (b) when the Corporation has transferred substantially all the risks and rewards of ownership, or (c) when it has neither transferred nor retained substantially all the risks and rewards of the assets but has transferred control over the asset or a proportion of the asset.

(viii) Impairment

The corporation assesses at each balance sheet date whether there is any objective evidence that a financial asset is impaired. If there is objective evidence that an impairment loss has been incurred, the loss amount is accounted for as follows:

(a) for assets carried at amortised cost, impairment loss is measured as the difference between the assets carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses are recognised in the statement of income.

(b) for investments available for sale, impairment represents a significant or prolonged decline in the fair value of the investment below its cost. The difference between the acquisition cost and the current fair value, less any impairment loss on the financial asset previously recognised in the statement of income – is removed from equity and recognised in the statement of income. Increases in fair value of equity instruments after impairment are recognised directly in equity.

In addition, in accordance with Central Bank of Kuwait instructions, a minimum general provision of 2% on all credit facilities net of certain restricted categories of collateral, and not subject to specific provision, is provided.

2.7 Repurchase and resale arrangements

The corporation enters into purchases (sales) of securities under agreements to resell (repurchase) substantially identical securities at a certain date in the future at a fixed price. The amounts paid are recognised as securities purchased under resale agreements. The difference between the purchase price and resale price is treated as interest income and is accrued over the life of the agreement using the effective interest method.

Investments sold under repurchase agreements continue to be recognised in the balance sheet and are measured in accordance with the relevant accounting policy for that investment. The proceeds from the sale of the investments are reported as part of liabilities as securities sold under repurchase agreements. The difference between the sale price and repurchase price is treated as interest expense and is accrued over the life of the agreement using the effective interest method.

2.8 Investment in projects and equity participations

Investment in enterprises in which the Corporation holds 20% or more of the voting capital and/or exercises significant influence over the financial and operating policies ("associates") are accounted for using the equity method.

Under the equity method, the investment in associates are carried in the balance sheet at cost plus post-acquisition changes in the net assets of the associates. Losses in excess of the cost of the associates are recognised when the Corporation has incurred liabilities on its behalf. The corporation's share of the results of operations of associates is recognised in the statement of income. Where there has been a change recognised directly in the equity of associates, the Corporation recognises its share of changes and discloses this, when applicable in the statement of changes in equity. Provision is made for any impairment losses and recognised in the statement of income (note 2.17).

Other investments in projects and equity participations are classified as investments available for sale. Provision is made for any impairment losses on an individual investment basis and is recognised as set out in note 2.6.

2.9 Property and other fixed assets

Property and other fixed assets are carried at cost less accumulated depreciation and impairment losses. An impairment loss is recognised in the statement of income whenever the carrying amount of an asset exceeds its recoverable amount. The recoverable amount of assets is the greater of their net selling price and value in use. Depreciation is computed on a straight-line basis over the estimated useful life of each asset category as follows:

Buildings	20 years
Building installations	5 - 10 years
Office equipment	3 - 4 years
Furniture	4 - 6 years
Motor vehicles	3 years

2.10 Other provisions

Other provisions are recognised in the balance sheet when the Corporation has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

2.11 Contingent liabilities

Contingent liabilities are possible obligations that arise from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the Corporation's control or are present obligations arising from past events that are not recognised as it is not probable that a transfer of economic benefits will occur or the amount cannot be measured with sufficient certainty.

2.12 Fiduciary activities

Assets managed for third parties or held in trust or in a fiduciary capacity are not treated as assets of the Corporation and accordingly are not included in these financial statements.

2.13 Hedge accounting

A hedging relationship exists where:

- at the inception of the hedge there is formal documentation of the hedge;
- the hedge is expected to be highly effective;
- the effectiveness of the hedge can be reliably measured;
- the hedge is highly effective throughout the reporting period; and
- for hedges of a forecasted transaction, the transaction is highly probable and presents an exposure to variations in cash flows that could ultimately affect net profit or loss.

Where there is a hedging relationship between a derivative instrument and a related item being hedged, the hedging instrument is measured at fair value. The treatment of any resultant gains and losses is set out below.

The fair value of derivative hedging instruments is calculated in the same way as the fair value of trading instruments (refer accounting policy 2.6 (iv)).

Where a derivative financial instrument hedges the exposure to changes in the fair value of a recognised asset or liability, the hedged item is stated at fair value in respect of the risk being hedged. Gains or losses on remeasurement of both the hedging instrument and the hedged item are recognised in the statement of income.

Where a derivative financial instrument hedges the exposure to variability in the cash flows of recognised assets or liabilities (or homogeneous groups/portfolios thereof) or anticipated transactions or firm commitments, the effective part of any gain or loss on remeasurement of the hedging instrument is recognised directly in equity. The ineffective part of any gain or loss is recognised in the statement of income.

When a hedged anticipated transaction or firm commitment results in the recognition of an asset or liability, the cumulative gain or loss on the hedging instrument recognised in equity is removed from equity and included in the initial measurement of the asset or liability. Otherwise the cumulative gain or loss recognised in equity is transferred to the statement of income at the same time that the hedged transaction affects net profit or loss and included in the same line item as the hedged transaction.

When a hedging instrument or hedge relationship is terminated but the hedged transaction is still expected to occur, the cumulative gain or loss recognised in equity remains in equity and is recognised in accordance with the above policy. If the hedged transaction is no longer expected to occur, the cumulative gain or loss recognised in equity is recognised in the statement of income immediately.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, no longer qualifies for hedge accounting or is revoked by the Corporation. For effective cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the statement of income.

2.14 Interest, fee income and dividend income

Interest income and expense is recognised on an accrual basis taking into account the effective yield of the instrument or an applicable floating rate. Interest income includes the amortisation of any discount or premium or other difference between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis. Fee income is recognised when earned. Dividend income is recognised when the right to receive payment is established.

2.15 Foreign currency

The reporting currency of the Corporation is the United States Dollar (“US Dollar”). The share capital of the Corporation is also denominated in US Dollars. Transactions in foreign currencies are converted to US Dollars at the rate of exchange prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are converted into US Dollars at market rates of exchange prevailing on the balance sheet date. Realised and unrealised foreign exchange gains and losses are included in the statement of income.

Non monetary items that are measured in terms of historical costs in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Translation gains or losses on non monetary items are included in equity as part of the fair value adjustment on securities available for sale, unless part of an effective hedging strategy. Any goodwill arising on the acquisition of a foreign operation is translated at the closing rate of exchange at the balance sheet date.

For investments in projects and investments equity accounted, the assets and liabilities are translated into the presentation currency of the Corporation at the exchange rate ruling the balance sheet date and their statements of income are translated at rates approximating average exchange rates for the year. The exchange differences arising on translation are taken directly to a separate component of equity. On disposal, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the statement of income.

2.16 Segment reporting

A segment is a distinguishable component of the Corporation that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segment income, segment expenses and segment performance include transfers between business segments and between geographical segments.

2.17 Significant accounting judgements and estimates

In the process of applying the Corporation's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect in the amounts recognised in the financial statements:

Classification of investments

Management decides on acquisition of a security whether it should be classified as held to maturity, held for trading, carried at fair value through statement of income, or available for sale.

For those deemed to be held to maturity management ensures that the requirements of IAS 39 are met and in particular the Corporation has the intention and ability to hold these to maturity.

The corporation classifies securities as trading if they are acquired primarily for the purpose of making a short term profit by the dealers.

Classification of investments as fair value through statement of income depends on how management monitors the performance of these investments. When they are not classified as held for trading but have readily available reliable fair values and the changes in fair values are reported as part of profit or loss in the management accounts, they are classified as fair value through statement of income.

All other investments are classified as available for sale.

Impairment of investments

The corporation treats investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgement. In addition, the Corporation evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for projects and unquoted equities.

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment losses on loans and advances and investment in debt instruments

The corporation reviews its problem loans and advances and investment in debt instruments at each reporting date to assess whether a provision for impairment should be recorded in the statement of income. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

Valuation of unquoted equity investments

Valuation of unquoted equity investments is normally based on one of the following:

- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same;
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics; or
- other valuation models.

The determination of the cash flows and discount factors for unquoted equity investments requires significant estimation. There are a number of securities where this estimation cannot be reliably determined and these are carried at cost as disclosed in note 8 and note 10. The corporation calibrates the valuation techniques periodically and tests these for validity using either prices from observable current market transactions in the same instrument or other available observable market data.

3 PLACEMENTS

Placements at December 31, 2006 included placements with non-bank financial institutions amounting to US$ 78.1 million (2005: US$ 85.8 million) shown net of provisions amounting to US$ 1.6 million (2005: US$ 1.8 million).

4 INTEREST BEARING SECURITIES AND FUNDS

(US$ million)	2006	2005
Debt and other interest bearing instruments available for sale		
AAA/Aaa rated debt securities	229.9	145.4
GCC Government securities	416.2	294.1
Debt securities of other investment grade issuers	2,728.1	2,818.9
Other debt securities	392.1	142.4
	3,766.3	3,400.8
Debt and other interest bearing instruments held to maturity		
AAA/Aaa rated debt securities	8.1	12.1
GCC Government securities	51.6	146.0
Debt securities of other investment grade issuers	64.8	82.1
Credit funds	450.0	450.0
Other debt securities	8.2	6.2
	582.7	696.4
Trading funds		
Money market enhanced liquidity funds	224.1	205.7
Bond funds	123.1	107.9
Credit funds	50.1	50.0
	397.3	363.6
Total	4,746.3	4,460.8
Analysis of debt securities:		
Instruments bearing interest at fixed rates	314.7	194.9
Instruments bearing interest at floating rates	4,034.3	3,902.3
Total	4,349.0	4,097.2

Interest bearing securities amounting to US$ 1,822.3 million (2005: US$ 2,014.8 million) are pledged as security in respect of borrowings under securities sold under repurchase agreements.

During the year a provision of US$ 0.4 million on interest bearing securities held to maturity was released (2005: US$ 1.0 million) on account of reversal of impairment losses. The investments shown above are net of provisions of US$ 0.2 million (2005: US$ 0.6 million).

5 EQUITIES AND MANAGED FUNDS

All equities are held through managed funds and are classified as follows:

(US$ million)	2006	2005
Trading securities	233.1	246.9
Available for sale securities	323.1	414.8
Alternative equity investments	597.5	518.6
	1,153.7	1,180.3

Trading securities comprise of investments in funds that actively trade in mortgage backed securities, managed futures, and equities issued within the GCC.

Available for sale securities comprise of investments in funds that invest in equity securities, real estate securities and subordinated notes.

Alternative equity investments comprise of investments in hedge funds and other alternative investments and these are designated as "fair value through statement of income".

6 LOANS

The movements in the provision for loan losses were as follows:

a) Provision for loan losses

(US$ million)	2006	2005
Balance at beginning of year	1.6	3.4
Amounts utilised	-	(1.7)
Net write back for the year	(0.2)	(0.1)
Balance at end of year	1.4	1.6

b) Provision for loan guarantees

(US$ million)	2006	2005
Balance at beginning of year	2.5	3.5
Net charge (write back) for the year	1.5	(1.0)
Balance at end of year	4.0	2.5

The policy of the Corporation for calculation of the impairment provision for loans complies in all material respects with the specific provision requirements of the Central Bank of Kuwait. According to the Central Bank of Kuwait instructions, a minimum general provision of 2% on all credit facilities net of certain restricted categories of collateral and not subject to specific provision has been provided.

7 RECEIVABLE FROM SHAREHOLDERS

Receivables from shareholders in the prior year consisted of the unpaid balance from the sale of Gulf International Bank ("GIB") to the shareholders on April 7, 2001. The outstanding balance along with interest was settled in full in the current period from dividends distributed by the Corporation (note 24).

8 PRIVATE EQUITY FUNDS

(US$ million)	2006	2005
Private equity funds – gross	264.3	217.0
Provision for impairment	(37.8)	(32.8)
	226.5	184.2

Investments in private equity funds are classified as investments available for sale. Investments in equity funds are carried at cost less any impairment losses, since the fair value of these investments cannot be reliably determined. There is no active market for these investments and there have not been any significant recent transactions that could provide reliable evidence of the current fair value.

The following is a summary of movements in the balance of provisions for impairment of equity funds.

(US$ million)	2006	2005
Balance at beginning of year	32.8	27.8
Net charge for the year	5.0	5.0
Balance at end of year	37.8	32.8

9 INVESTMENT IN PROJECT HELD FOR SALE

On May 27, 2006 the Corporation acquired the remaining 50 percent of the shares outstanding of Gulf Industrial Investment Company (E.C.) ("the Project") for consideration of US$ 377.0 million. The corporation previously had an ownership of 50 percent in the Project, under a joint venture arrangement with another party. Subsequently, a portion of the acquired shares, representing 25% of the investment were sold with a realised gain on sale of US$ 20.5 million. The remaining 25 percent of the investment has been sold in January 2007.

10 INVESTMENT IN PROJECTS AND EQUITY PARTICIPATIONS

(US$ million)	2006	2005
Project investments equity accounted	372.1	320.6
Other project investments and equity participations	526.6	439.1
Goodwill	39.6	36.3
	938.3	796.0
Provision for impairment	(59.8)	(59.8)
	878.5	736.2

Provision for impairment consists of provision for investments equity accounted of US$ 5.6 million (2005: US$ 4.3 million) and provision for impairment of other project investments and equity participations of US$ 54.2 million (2005: US$ 55.5 million).

a) Project investments equity accounted

The following table illustrates the summarised financial information of the Corporation's investments in projects equity accounted:

(US$ million)	2006	2005
Share of assets	1,027.3	817.2
Share of liabilities	655.2	496.6
Share of net assets	372.1	320.6
Provisions	(5.6)	(4.3)
Carrying amount of investment	366.5	316.3
Share of profit for the year	55.3	89.1

There are no material investments in project investments equity accounted listed on any public exchange.

b) Other project investments and equity participations

(US$ million)	2006	2005
Listed investments	359.1	247.7
Unlisted investments	167.5	191.4
	526.6	439.1

Unlisted investments are carried at cost less any impairment losses, since the fair value of these investments cannot be reliably determined. There is no active market for these investments and there have not been any recent significant transactions that could provide reliable evidence of the current fair value.

c) Provision for impairment in investments in projects and equity participations

The movement in the provisions are as follows:

(US$ million)	2006	2005
Balance at beginning of year	59.8	54.0
Amounts utilised	(1.3)	(1.9)
Net charge for the year	1.3	7.7
Balance at end of year	59.8	59.8

11 PROPERTY AND OTHER FIXED ASSETS

(US$ million)	Cost	Accumulated depreciation	2006 Net book value	2005 Net book Value
Building and installations	28.8	10.1	18.7	20.4
Furniture, equipment and motor vehicles	10.7	9.0	1.7	1.5
	39.5	19.1	20.4	21.9

There were no significant additions or disposals during the year. The depreciation charge for the year is US$ 2.9 million (2005: US$ 2.7 million).

12 OTHER ASSETS

(US$ million)	2006	2005
Accrued interest, fees and commissions	140.7	98.3
Derivative assets used for hedging	6.6	21.6
Employees' end of service benefit asset	40.0	34.9
Prepayments	0.4	0.6
Other, including accounts receivable	19.0	9.6
	206.7	165.0

13 DEPOSITS

(US$ million)	2006	2005
Deposits from Central Banks	427.9	422.1
Deposits from other banks	834.5	1,042.3
Deposits from islamic institutions	387.8	303.7
Other deposits	481.2	293.0
	2,131.4	2,061.1

At December 31, 2006 deposits from GCC Country Governments, Central Banks and other institutions headquartered in the GCC States amounted to US$ 1,744.6 million (2005: US$ 1,360.0 million).

14 TERM FINANCE

(US$ million)	2006	2005
GIC US Dollar floating rate note due in 2007	300.0	300.0
US Dollar floating rate term loan due in 2010	200.0	200.0
Euro Medium Term Note Issues (EMTN) :		
GIC US Dollar floating rate note due in 2009	500.0	500.0
GIC US Dollar floating rate note due in 2010	500.0	500.0
GIC Euro floating rate note due in 2011	527.0	-
GIC HK Dollar floating rate note due in 2011	19.3	-
	2,046.3	1,500.0

15 OTHER LIABILITIES

(US$ million)	2006	2005
Accrued interest	97.4	77.9
Derivative liabilities used for hedging	13.8	63.4
Employees' end of service benefits	42.9	37.9
Other provisions	4.0	2.4
Other, including accounts payable and accrued expenses	30.1	20.7
	188.2	202.3

16 EQUITY

16.1
The authorised and issued capital comprises of 2.1 million shares of US$ 1,000 each (2005: 2.1 million shares of US$ 1,000 each). The paid up capital is US$ 750 million (2005: US$ 750 million). The Board of Directors have proposed to increase paid up capital to US$ 1,000 million through capitalisation of retained earnings, subject to approval of the shareholders at the Annual General Assembly Meeting.

16.2
In accordance with the Kuwait Commercial Companies' Law and the Corporation's Articles of Association, 10 percent of the net income for the year is required to be transferred to the non-distributable compulsory reserve until the reserve reaches a minimum of 50 percent of share capital.

16.3
In accordance with the Corporation's Articles of Association, 10% of the net income for the year is required to be transferred to the voluntary reserve. The transfer to this reserve can be discontinued by a resolution adopted in the general assembly meeting of the shareholders.

16.4
Investment revaluation reserve comprises the cumulative net change in the fair value of investments available for sale held by the Corporation and the Corporation's share of movements in the investment revaluation reserve of associated companies.

17 INTEREST AND SIMILAR INCOME

(US$ million)	2006	2005
Placements	39.8	27.2
Securities	212.9	160.5
Loans	1.5	1.6
Receivable from shareholders	0.2	2.5
	254.4	191.8

18 INVESTMENT AND FEE INCOME

(US$ million)	2006	2005
Net gain on interest bearing securities and funds	23.3	13.4
Net gain on equities and managed funds	109.2	94.4
Net gain on sale of investment in projects and equity participations	122.5	45.0
Income from private equity funds	27.7	26.7
Income from projects and equity participations	55.3	89.1
Income from investment in project held for sale (note 9)	19.8	-
Profit on foreign exchange	0.4	0.4
Dividend income	17.8	21.6
Fees, commissions and sundry income	29.5	18.5
	405.5	309.1

Net gains on disposal of available for sale investments transferred from equity amounting to US$ 128.5 million (2005: US$ 90.7 million) are included under the respective categories.

19 GAIN ON EXCHANGE OF INVESTMENT AVAILABLE FOR SALE

On September 2, 2006, as part of a merger agreement between the shareholders of National Petrochemical Industrialization Company (NPIC), in which the Corporation had an ownership of 11.91 percent, and National Industrialization Company (NIC) a company listed on the Saudi Stock Exchange and the parent company of NPIC, the Corporation's shares in NPIC were exchanged at a rate of 0.77 shares of NIC.

The bid price for NIC's shares on the date of exchange was Saudi Riyals 78.0 (equivalent US$ 20.8). Subsequent to the date of exchange, the listed price of NIC's shares fell significantly and at December 31, 2006, the bid price of shares in NIC was Saudi Riyals 48.0 (equivalent US$ 12.8), which is the value at which these are carried at December 31, 2006.

20 INTEREST AND SIMILAR EXPENSES

(US$ million)	2006	2005
Securities sold under repurchase agreements	110.4	68.1
Deposits	72.3	53.6
Term finance	97.2	49.5
	279.9	171.2

Included in interest expense is US$ 66.5 million (2005: US$ 24.1 million) relating to interest incurred on liabilities to fund non interest bearing assets.

21 INCOME FROM RECOVERY OF DEBT

On July 23, 2006, an agreement was reached for the recovery of amounts due from entities within the Republic of Iraq to external parties. Pursuant to the settlement agreement, the Corporation received bonds from one of these parties with a fair value on the date of settlement of US$ 111.4 million. The bonds have a final maturity date of January 15, 2028 and have been classified as investments available for sale and included within 'interest bearing securities and funds' (note 4). The related interest income from these securities is included within interest and similar income (note 17).

22 PROVISION FOR IMPAIRMENT LOSSES

(US$ million)	2006	2005
Placements with non-bank financial institutions	0.2	(1.8)
Private equity funds	(5.0)	(5.0)
Projects and equity participations	-	(7.7)
Loans and loan guarantees	(1.3)	1.1
Interest bearing securities and funds – held to maturity	0.4	1.0
Accounts receivable	0.2	1.0
	(5.5)	(11.4)

23 RETIREMENT AND OTHER TERMINAL BENEFITS

The corporation has defined voluntary contribution and end of service indemnity plans which cover all its employees. Contribution to the voluntary plan is based on a percentage of pensionable salary and consists of contribution by employees and a matched contribution up to a certain limit by the Corporation. Contribution to the end of service indemnity plan is based on a percentage of pensionable salary and number of years of service by the employees. The amounts to be paid as the end of service benefits are determined by reference to the amounts of the contributions and investment earnings thereon. The corporation also pays contributions to Government defined contribution pension plan for certain employees in accordance with the legal requirements in Kuwait.

The total cost of retirement and other end of service benefits included in staff expenses for the year ended December 31, 2006 amounted to US$ 4.7 million (2005: US$ 3.8 million).

24 DIVIDEND

The Board of Directors have recommended a dividend of 31.5% on paid up capital for the year ended December 31, 2006 (2005: 23.6%). Dividends for the year ended December 31, 2005 were partially utilised to settle receivable from shareholders (note 7).

On February 16, 2006, at the annual general assembly meeting, the shareholders approved the financial statements for the year ended December 31, 2005 and the dividend proposed for that year.

25 RISK MANAGEMENT

25.1 Liquidity risk

Liquidity risk is the risk that the Corporation will be unable to meet its liabilities when they fall due. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind, and monitors liquidity on a daily basis.

The asset and liability maturity profile shown in the table below is based on contractual repayment arrangements and as such does not take account of the effective maturities of deposits and of borrowers' right to prepay obligations with or without prepayment penalties.

(US$ million)	Within 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
At December 31, 2006					
Assets					
Cash and cash equivalents	4.3	-	-	-	4.3
Placements	236.6	411.0	-	-	647.6
Securities purchased under resale agreements	13.7	-	-	-	13.7
Interest bearing securities and funds	112.1	389.4	2,501.4	1,743.4	4,746.3
Equities and managed funds	-	-	-	1,153.7	1,153.7
Loans	0.9	7.3	8.8	-	17.0
Private equity funds	12.1	5.9	50.0	158.5	226.5
Investment in project held for sale	198.4	-	-	-	198.4
Investments in projects and equity participations	-	-	-	878.5	878.5
Property and other fixed assets	-	-	-	20.4	20.4
Other assets	121.1	42.1	2.8	40.7	206.7
Total assets	699.2	855.7	2,563.0	3,995.2	8,113.1
Liabilities and equity					
Deposits	1,747.1	261.9	19.1	103.3	2,131.4
Securities sold under repurchase agreements	1,413.3	422.7	-	-	1,836.0
Term finance	-	300.0	1,746.3	-	2,046.3
Other liabilities	98.3	40.9	2.0	47.0	188.2
Equity	-	-	-	1,911.2	1,911.2
Total liabilities and equity	3,258.7	1,025.5	1,767.4	2,061.5	8,113.1
At December 31, 2005					
Total assets	856.5	566.7	2,204.5	3,817.3	7,445.0
Total liabilities and equity	3,768.3	420.8	1,549.2	1,706.7	7,445.0

The asset and liability maturity profile shown in the table below is based on management's assessment of the Corporation's right and ability to liquidate these instruments based on their underlying liquidity characteristics.

(US$ million)	Within 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
At December 31, 2006					
Assets					
Cash and cash equivalents	4.3	-	-	-	4.3
Placements	236.6	411.0	-	-	647.6
Securities purchased under resale agreements	13.7	-	-	-	13.7
Interest bearing securities and funds	3,933.1	167.8	427.9	217.5	4,746.3
Equities and managed funds	1,083.9	8.7	-	61.1	1,153.7
Loans	0.9	7.3	8.8	-	17.0
Private equity funds	12.1	5.9	50.0	158.5	226.5
Investment in project held for sale	198.4	-	-	-	198.4
Investments in projects and equity participations	359.1	-	-	519.4	878.5
Property and other fixed assets	-	-	-	20.4	20.4
Other assets	143.2	20.0	2.8	40.7	206.7
Total assets	5,985.3	620.7	489.5	1,017.6	8,113.1
Liabilities and equity					
Deposits	1,747.1	261.9	19.1	103.3	2,131.4
Securities sold under repurchase agreements	1,413.3	422.7	-	-	1,836.0
Term finance	-	300.0	1,746.3	-	2,046.3
Other liabilities	98.3	40.9	2.0	47.0	188.2
Equity	-	-	-	1,911.2	1,911.2
Total liabilities and equity	3,258.7	1,025.5	1,767.4	2,061.5	8,113.1
At December 31, 2005					
Total assets	6,028.9	176.6	238.4	1,001.1	7,445.0
Total liabilities and equity	3,768.3	420.8	1,549.2	1,706.7	7,445.0

25.2 Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. The corporation is exposed to interest rate risk as a result of mismatches of interest rate repricing of assets and liabilities. The Board has established levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods.

Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

The repricing profile shown in the table below is based on the remaining period to the next interest repricing date. The repricing profiles of floating rate investment securities incorporate the effect of interest rate swaps used to modify the interest rate characteristics of specific transactions.

(US$ million)	Within 3 months	3 months to 1 year	Over 1 year	Non-interest bearing items	Total	Effective interest rate %
At December 31, 2006						
Assets						
Cash and cash equivalents	4.3	-	-	-	4.3	4.20
Placements	236.6	411.0	-	-	647.6	6.48
Securities purchased under resale agreements	13.7	-	-	-	13.7	3.32
Interest bearing securities and funds:						
Fixed rate	3.5	25.0	286.2	-	314.7	5.80
Floating rate	2,561.5	1,472.8	-	-	4,034.3	4.16
Trading funds	-	-	-	397.3	397.3	-
Equities and managed funds	-	-	-	1,153.7	1,153.7	-
Loans	0.9	7.3	9.1	(0.3)	17.0	6.02
Private equity funds	-	-	-	226.5	226.5	-
Investment in projects held for sale	-	-	-	198.4	198.4	-
Investment in projects and equity participations	-	-	-	878.5	878.5	-
Property and other fixed assets	-	-	-	20.4	20.4	-
Other assets	-	-	-	206.7	206.7	-
Total assets	2,820.5	1,916.1	295.3	3,081.2	8,113.1	
Liabilities and equity						
Deposits	1,747.1	261.9	19.1	103.3	2,131.4	5.30
Securities sold under repurchase agreements	1,413.3	422.7	-	-	1,836.0	4.17
Term finance	2,046.3	-	-	-	2,046.3	5.32
Other liabilities	-	-	-	188.2	188.2	-
Equity	-	-	-	1,911.2	1,911.2	-
Total liabilities and equity	5,206.7	684.6	19.1	2,202.7	8,113.1	
Derivative instruments	231.9	(231.9)	-	-	-	
Interest rate sensitivity gap	(2,154.3)	999.6	276.2	878.5	-	
Cumulative interest rate sensitivity gap	(2,154.3)	(1,154.7)	(878.5)	-	-	
At December 31, 2005						
Interest rate sensitivity gap	(1,616.4)	1,032.8	33.8	549.8	-	
Cumulative interest rate sensitivity gap	(1,616.4)	(583.6)	(549.8)	-	-	

25.3 Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The corporation views the US Dollar as its functional currency. The Board has set limits on positions by currency. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within established limits.

The corporation had the following significant net exposures denominated in foreign currencies:

(US$ million)	2006 Equivalent long (short)	2005 Equivalent long (short)
UAE Dirhams	80.5	8.9
Bahraini Dinars	11.5	-
Kuwaiti Dinars	83.1	10.4
Omani Riyals	33.6	7.7
Qatari Riyals	57.1	10.2
Saudi Riyals	519.9	210.0

25.4 Market risk

Market risk arises from fluctuations in interest rates, foreign exchange rates and equity prices. The Board has set limits on the value of risk that may be accepted. This is monitored on a weekly basis by the Global Market Investment Committee.

25.5 Equity price risk

Equity price risk arises from the change in fair values of equity investments. The corporation manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

25.6 Credit risk and concentration of assets, liabilities and off balance sheet items

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Board has set limits for individual borrowers, and groups of borrowers and for geographical and industry segments. The corporation also monitors credit exposures, and continually assesses the creditworthiness of counterparties. In addition, the Corporation obtains security where appropriate, enters into master netting agreements and collateral arrangements with counterparties, and limits the duration of exposures.

Credit risk in respect of derivative financial instruments is limited to those with positive fair values, which are included under other assets. As a result the maximum credit risk, without taking into account the fair value of any collateral and netting agreements, is limited to the amounts on the balance sheet plus commitments to customers disclosed in note 26.

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Corporation's performance to developments affecting a particular industry or geographic location.

The distribution of assets and off-balance sheet items by geographic region and sector was as follows:

(US$ million)	2006 Assets	2006 Credit commitments	2005 Assets	2005 Credit commitments
Geographic region:				
GCC	2,978.5	146.2	2,493.9	63.3
Other Middle East and North Africa	107.2	-	22.4	-
Europe	2,285.3	-	2,234.0	-
North America	2,611.9	-	2,548.5	-
Asia	130.2	-	146.2	-
	8,113.1	146.2	7,445.0	63.3
Sector:				
Banks and financial institutions	5,437.0	-	4,744.4	-
Trading and manufacturing	1,649.0	69.0	1,423.5	58.0
Utilities	147.0	77.2	437.5	5.3
Government and Government agencies	803.0	-	718.5	-
Other	77.1	-	121.1	-
	8,113.1	146.2	7,445.0	63.3

26 COMMITMENTS AND CONTINGENT LIABILITIES

In the usual course of meeting the requirements of customers, the Corporation has commitments to extend credit and provide financial guarantees and letters of credit to guarantee the performance of customers to third parties. The credit risk on these transactions is generally less than the contractual amount. The table below sets out the notional principal amounts of outstanding commitments.

Credit Risk Amounts

(US$ million)	2006 Notional principal amount	2005 Notional principal amount
Transaction-related contingent items	143.2	59.3
Undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	3.0	4.0
	146.2	63.3

The above commitments and contingent liabilities have off balance-sheet credit risk because only origination fees and accruals for probable losses are recognised in the balance sheet until the commitments are fulfilled or expired. Many of the contingent liabilities and commitments will expire without being advanced in whole or in part. Therefore, the amounts do not represent expected future cash flows.

The corporation had the following capital commitments as at the balance sheet date:

(US$ million)	2006	2005
Undrawn commitments in investments in private equity funds	138.2	183.1
Undrawn commitments in investments in projects and equity participations	19.5	33.5
	157.7	216.6

27 DERIVATIVES AND FOREIGN EXCHANGE PRODUCTS

Derivatives and foreign exchange instruments are utilised by the Corporation to meet the needs of its customers, to generate trading revenues and as part of its asset and liability management activity to hedge its own exposure to market, interest rate and currency risk.

In the case of derivative transactions the notional principal typically does not change hands. It is simply a quantity, which is used to calculate payments. While notional principal is a volume measure used in the derivatives and foreign exchange markets, it is neither a measure of market nor credit risk. The corporation's measure of credit exposure is the cost of replacing contracts at current market rates should the counterparty default prior to the settlement date. Credit risk amounts represent the gross unrealised gains on transactions before taking account of any collateral held or any master netting agreements in place.

Hedge accounting

Interest rate swaps under which the Corporation pays a fixed rate and receives a floating rate are used in fair value hedges of fixed interest securities available-for-sale.

As at the balance sheet date the notional amount of interest rate swaps used to hedge interest rate risk amounted to US$ 2,188.2 million (2005: US$ 2,247.7 million) and its net fair value was a swap loss of US$ 11.8 million (2005: US$ 61.8 million). The corresponding gain on the hedged fixed income securities amounted to US$ 12.7 million (2005: US$ 59.4 million).

Notes to the Financial Statements

For the year ended December 31, 2006

Trading activities

The table below summarises the aggregate notional amounts and net fair value of foreign exchange and derivative financial instruments held for trading.

(US$ million)	Notional amounts	Net fair values	Credit risks amounts
As at December 31, 2006			
Foreign exchange contracts:			
Unmatured spot, forward and futures contracts	1,688.9	3.8	4.5
As at December 31, 2005			
Foreign exchange contracts:			
Unmatured spot, forward and futures contracts	1,407.4	2.4	3.3

Maturity analysis

(US$ million)	Year 1	Year 2 to 5	Total
At December 31, 2006			
Notional amounts			
Foreign exchange contracts	1,669.6	19.3	1,688.9
At December 31, 2005			
Notional amounts			
Foreign exchange contracts	1,407.4	-	1,407.4

28 SEGMENTAL INFORMATION

The primary segment reporting format is determined to be business segments as the Corporation's risks and rates of return are affected by differences in the products and services produced. Secondary information is reported geographically.

Primary Segment
For management purposes the Corporation is divided into five main business segments:

The principal investment division is responsible for actively investing in projects and equity participations.

Debt capital market segment provides a stable coupon/spread income and a reserve of additional liquidity. The investments comprise of high quality marketable debt securities diversified across a wide range of geographic and industry sectors.

Equities and alternative investments segment manages a diversified set of portfolios in an array of different asset classes and investment themes that comprise investments ranging from equities to structured finance, private equity, market neutral, hedge funds and other alternative assets.

The treasury division manages the Corporation's liquidity, short-term interest rate and foreign exchange activities using a variety of on and off-balance sheet treasury applications. The division trades on its own accounts and for clients in spot and forward foreign exchange and options, cash money markets, floating rate notes, interest rate swaps and other derivatives.

The "Corporate and other" category comprises items which are not directly attributable to specific business segments, including investments of a strategic nature, and income arising on the recharge of the Corporation's net free capital to business units. Other operations of the Corporation include asset management, operations, risk management and financial control. Transactions between business segments are conducted at estimated market rates on an arm's length basis. Interest is charged/credited to business segments based on rates which approximate the marginal cost of funds.

These segments are the basis on which the Corporation reports its primary segment information.

Notes to the Financial Statements

For the year ended December 31, 2006

(US$ million)	Principal investments	Debt capital markets	Equity and alternative investments	Treasury	Corporate and other	Eliminations	Total
December 31, 2006							
Interest and similar income	1.5	173.3	30.7	40.5	87.8	(79.4)	254.4
Investment and fee income	204.0	9.6	142.2	10.7	34.8	4.2	405.5
Gain on exchange of investment available for sale	170.4	-	-	-	-	-	170.4
Interest expense and similar charges	(62.6)	(156.1)	(90.4)	(39.6)	(10.8)	79.6	(279.9)
Net operating income	313.3	26.8	82.5	11.6	111.8	4.4	550.4
Other operating expenses	(8.3)	(1.9)	(1.5)	(3.0)	(37.1)	(4.4)	(56.2)
Provision for impairment losses	(1.3)	0.4	(5.0)	0.2	0.2	-	(5.5)
Segment results	303.7	25.3	76.0	8.8	74.9	-	488.7
Income from recovery of debt							111.4
Net income for the year							600.1
Other information							
Segment assets	1,139.5	3,890.8	1,877.8	925.2	279.8	-	8,113.1
Segment liabilities	717.4	3,713.9	1,740.9	29.7	-	-	6,201.9
Equity							1,911.2
Total liabilities and equity							8,113.1
December 31, 2005							
Interest and similar income	1.5	132.6	25.7	29.5	39.9	(37.4)	191.8
Investment and fee income	154.9	12.3	131.7	2.5	6.4	1.3	309.1
Interest expense and similar charges	(21.7)	(106.8)	(56.7)	(23.4)	-	37.4	(171.2)
Net operating income	134.7	38.1	100.7	8.6	46.3	1.3	329.7
Other operating expenses	(7.2)	(1.8)	(1.7)	(3.0)	(30.5)	(1.3)	(45.5)
Provision for impairment losses	(7.7)	1.0	(5.0)	(1.8)	2.1	-	(11.4)
Segment results	119.8	37.3	94.0	3.8	17.9	-	272.8
Other information							
Segment assets	772.5	3,696.0	1,863.8	923.9	188.8	-	7,445.0
Segment liabilities	443.1	3,596.3	1,677.0	86.4	-	-	5,802.8
Equity							1,642.2
Total liabilities and equity							7,445.0

Secondary segment information

Although the management of the Corporation is based primarily on business segments, the Corporation operates in two geographic markets – the GCC region and International. The following table shows the distribution of the Corporation's gross operating income and total assets by geographical segment:

December 31, 2006

	GCC Region		International		Total	
(US$ million)	PI	Others	PI	Others	PI	Others
Gross operating income	313.3	63.2	-	173.9	313.3	237.1
Total assets	1,119.5	1,859.1	20.0	5,114.5	1,139.5	6,973.6

December 31, 2005

	GCC Region		International		Total	
(US$ million)	PI	Others	PI	Others	PI	Others
Gross operating income	134.7	54.0	(12.0)	153.0	122.7	207.0
Total assets	750.1	1,743.8	22.4	4,928.7	772.5	6,672.5

29 FAIR VALUE INFORMATION

As at the balance sheet date the fair value of financial assets and financial liabilities that are not carried at fair value is not materially different from their carrying amounts, except for debt and other interest bearing instruments held-to-maturity (see note 4), whose fair value is US$ 1.7 million higher than their carrying value (2005: US$ 3.2 million) and certain unlisted equity securities whose fair value cannot be reliably determined (see note 8 and note 10).

30 RELATED PARTY TRANSACTIONS

Related parties represent affiliated companies, directors and key management personnel of the Corporation, and companies which they control or over which they exert significant influence. Pricing policies and terms of these transactions are approved by the Corporation's management.

There were no material transactions and balances with affiliated companies within and at the end of the current year (2005: Nil).

Information on receivable from shareholders settled during the year and the related interest income is disclosed in notes 7 and 17 respectively.

Compensation of key management personnel

The remuneration of key management personnel during the year was as follows:

(US$ million)	2006	2005
Short-term employee benefits	8.0	5.5
Post employment and termination benefits	1.2	0.8
	9.2	6.3

Included in other assets are loans to key management personnel amounting to US$ 1.2 million (2005: US$ 0.2 million).

31 FIDUCIARY ACTIVITIES

At December 31, 2006 third party assets under management (at fair value) amounted to US$ 492.1 million (2005: US$ 538.2 million). These assets are managed in a fiduciary capacity and are therefore excluded from the balance sheet.

32 COMPARATIVES

The presentation of investment securities has been amended in the current year. Investment securities are now categorised in accordance with the nature of the underlying securities into 'equities and managed funds' or 'interest bearing securities and funds. Prior year figures have been reclassified to be consistent with current year presentation as follows:

Credit funds amounting to US$ 450.0 million have been reclassified from the prior year account 'Loans and credit funds' to 'Interest bearing securities and funds.'

Equity investments available for sale amounting to US$ 414.8 million have been reclassified from the prior year account 'Investment securities' to 'Equities and managed funds.'

Investments in trading funds amounting to US$ 363.6 million have been reclassified from the prior year account 'Trading securities and managed funds' to 'Interest bearing securities and funds.'

Associated income and cash flows have been reclassified as appropriate within the statements of income and cash flows respectively.

Direct Investments

US $ million	Location	Total shareholders equity	GIC's share of capital (%)
Non-Consolidated subsidiary and associated companies			
Bituminous Products Company Limited (Bitumat)	Saudi Arabia	23.2	100.0
Gulf Denim Limited	UAE	4.9	100.0
Investel Holdings W.L.L.	Bahrain	52.3	100.0
Gulf Paramount for Electrical Services Company WLL	Kuwait	4.2	93.4
GIC Technology Partnership Co.	Kuwait	5.2	80.0
Gulf Industrial Investment Co. (E.C.)	Bahrain	111.3	75.0
Gulf Jyoti International	UAE	8.9	70.0
Crown Paper Mill Ltd. FZC	UAE	22.3	51.0
Delta Gulf Services FZ-LLC	UAE	0.5	50.0
Oman Investment Co.	Oman	26.5	50.0
United Stainless Steel Company B.S.C. (Closed)	Bahrain	77.1	50.0
Gulf Electronic Tawasul Company KSCC	Kuwait	2.1	47.5
Al Ezzel Power Company B.S.C.	Bahrain	7.4	45.0
Bahrain Industrial Pharmaceutical Co.	Bahrain	1.8	40.0
The National Titanium Dioxide Co., Ltd. (CRISTAL)	Saudi Arabia	162.8	33.0
A'Saffa Poultry Farms Co. SAOG	Oman	4.3	30.9
Jeddah Cable Company	Saudi Arabia	68.5	25.0
Kuwait International Advanced Industries Company K.S.C.	Kuwait	13.8	25.0
Oman Fiber Optic Co. SAOG	Oman	13.4	25.0
Technical Supplies & Services Co. Ltd.	UAE	26.4	25.0
Interplast Company Limited - (L.L.C.)	UAE	109.7	23.5
Celtex Weaving Mills Co. Ltd.	Bahrain	5.5	23.0
Rawabi Emirates (PJSC)	UAE	67.5	22.5
Advanced Electronics Company Ltd. (AEC)	Saudi Arabia	53.7	20.0
Gulf Stone Company SAOG	Oman	4.3	20.0
Oman Polypropylene LLC	Oman	89.7	20.0
Equity Participations			
Tatweer Infrastructure Company (Q.S.C.C.)	Qatar	144.2	13.0
Arab Pesticide Industries Co. (MOBEED)	Saudi Arabia	2.1	12.5
Arab Qatari Co. for Dairy Production	Qatar	19.9	10.8
Gulf Ferro Alloys Company (SABAYEK)	Saudi Arabia	53.6	10.0
Ras Laffan Power Company Limited (Q.S.C.)	Qatar	140.3	10.0
Rasameel Structured Finance Co. K.S.C.	Kuwait	106.0	10.0
NoCo A L. P.	USA	193.8	9.3
KGL Logistics Company K.S.C. (Closed)	Kuwait	75.5	9.0
Securities and Investment Company B.S.C.	Bahrain	74.8	8.0
National Industrialization Co. (NIC)	Saudi Arabia	1,484.3	7.9
Gulf Aluminium Rolling Mill Co. B.S.C.	Bahrain	165.6	5.9
Arabian Industrial Fibers Company (IBN RUSHD)	Saudi Arabia	300.5	4.7
Jarir Marketing Co.	Saudi Arabia	168.7	4.5
Zamil Industrial Investment Co.	Saudi Arabia	197.7	4.5
United Power Company SAOG	Oman	117.3	2.0
Al-Razzi Holding Company K.S.C.	Kuwait	193.4	2.0
Thuraya Satellite Telecommunications Company PJSC	UAE	711.8	1.7
Yanbu National Petrochemical Co. (YANSAB)	Saudi Arabia	1,534.0	0.9

Investment Products

The Fund / Currency	Inception Date	Investment Objectives
GCC Funds		
1 Gulf Premier Fund / US$	April 2003	• Attain capital appreciation through investments in GCC equity markets. • Achieve competitive returns against a GCC equities index.
2 Protected Gulf Premier Notes / US$	December 2005	• Provide safe access vehicle to the growing GCC equity through a capital guaranteed notes on Gulf Premier Fundmarkets.
3 Gulf Bond Fund / US$	March 2005	• Maximize income returns through investments in debt issues of GCC entities. • Preservation of capital and lower volatility of total returns.
4 GIC KD Bond Fund / KD	May 2003	• Maximize current income and price appreciation consistent with preservation of capital and lower volatility through investment in debt issues in Kuwaiti markets.
Global Funds		
1 GIC Global REITS Fund / US$	December 2005	• Deliver capital appreciation through investments in global Real Estate securities listed in US, Europe and Asian equity markets. • Achieve competitive and stable returns.
2 Alternative Strategies Fund / US$	August 1999	• The fund is a portfolio of hedge funds that is diversified across a broad mix of styles and strategies that seek to generate long-term capital appreciation while maintaining a low correlation with traditional global financial markets. • Risk Objective: Less volatile than traditional equity investments, emphasizing preservation of capital in down markets. • Achieve annual total returns in the range of LIBOR plus 3% to 5%. • Provide returns with low volatility 2%-4%.
3 GIC Event-Driven Fund / US$	July 2002	• A fund of hedge funds focused on event-driven hedge fund strategies. • Absolute annual returns in the range of LIBOR plus 4% to 8%. • Achieve those returns within volatility of 3% to 5%. • Provide returns with low correlation to the general direction of the traditional equity, fixed income and credit markets.
4 GIC Managed Equities Fund / US$	July 2002	• Investment in a range of different equity related strategies. • Achieve long term capital growth by investing in a diversified global equity portfolio. • Gain higher returns compared to MSCI World Index.
5 Khaleej II CDO / US$	November 2005	• The first managed CDO using the “pay-as-you-go” credit default swap of grade ABS. • Achieve income and stability of returns. • Provide an IRR of 10.5% per annum for subordinated note holders. • Quarterly distributions.
6 Khaleej I CDO / US$	September 2002	• Managed high grade credit structure (CDO) of multi-sector including corporate, financials and ABS. • Achieve income and stability. • Annual returns of LIBOR plus 6% for subordinated note holders. • Provide Semi-annual distributors.

Corporate Directory

Senior Management

Chief Executive Officer & General Manager
Hisham Abdulrazzaq Al-Razzuqi

Deputy General Manager & Head of Finance & Administration
Rashid Bin Rasheed

Global Markets

Acting Head of Global Markets & Head of Debt Capital Markets
Abdulaziz Al-Mulla

Funding & Liquidity
Martin Joy

Money Markets
Mathew Abraham

Head of Business Development
Malek Al-Ajeel

Head of Managed Funds
Sean Daykin

Head of Structured Products & Product Development
Maan Kantar

Head of GCC Equities
Talal Al-Tawari

GCC Fund Management
Waleed Al-Braikan

GCC Equity Research
Chinku Thankappan

Principal Investing

Head of Utilities and Financial Services
Shafic Ali

Head of Manufacturing Projects
Khaled Al-Qadeeri

Head of GCC Diversified Projects
Mohammad Al-Melhem

Head of Investment Banking
Ross Howard

Head of Project Finance
Robert Montgomery

Finance & Administration

Head of Information Technology
Hani Al-Shakhs

Head of Financial Control
Hazem El-Rafie

Head of Operations
Shawki Khalaf

Acting Head of Human Resources & Administration
Fahad Al-Abdulkader

Corporate Office

Head of Economics & Strategy
Dr. Soliman Demir

Head of Risk Management
Nabil Guirguis

Head of Internal Audit
Hamdy El-Sayed

Secretary to the Board
Dr. Ahmad Al-Haji

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