

**Bayan
Investment
Company
SAK**

April 2006

Bond Rating Review

Bayan Investment Company SAK

Kuwait

April 2006

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BAYAN INVESTMENT COMPANY SAK

Kuwait
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KWD20mn February 2005 Bond Issue		
<i>Rating</i> BBB-		<i>Outlook</i> Stable
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AUDITED BALANCES AT FYE:			CI RATIOS AT FYE:		
KWDmn	12/05	12/04	%	12/05	12/04
Total Assets	169.8	94.4	Return on Average Assets	22.6	34.3
Total Capital	98.3	74.6	Return on Average Equity	36.1	45.0
Bank Debt	43.9	15.8	Leverage	0.73	0.27
Net Profit	31.2	27.8	Current ratio	1.74	2.98

POSITIVE FACTORS

- Good profitability over the last three years
- Strong internal controls
- Good liquidity despite some tightening in 2005

NEGATIVE FACTORS

- The core investment holdings imply a degree of risk concentration.
- Increase in leverage
- Lack of diversification of revenue streams
- Probable sharp decline in profitability this year, especially in the near term due to market correction and earnings volatility

PROFILE BAYAN Investment Company (Bayan) was established in July 1997. The company has been quoted on the KSE since May 2003. Major shareholders with stakes of 5% or above include Al Ahli Bank of Kuwait (9.63%), Garorta Real Estate Co (9.16%), Behbehani Financial Co (7.50%) and Faisal Ali Al Mutawa & Sons Co (7.34%). The Company largely invests in local quoted equities either directly or via managed funds. There are however also smaller exposures to unquoted local equities, GCC quoted equities and to private equity. During 2005 Bayan entered the real estate market through its Bunyan Real Estate Company subsidiary.

RATING RATIONALE As at the end of 2005, Bayan had a reasonably strong balance sheet and good liquidity, although leverage had been increasing. Profitability was also very good, with net profits for the year and the previous two years being at high levels. It is fortunate that such gains were made, and more so that the gains were largely retained within the Company as the current year is likely to be a much tougher one for investment companies in Kuwait, and particularly those with limited diversification in revenue streams. The recent correction in the Kuwait market (and in the markets of nearly all other GCC markets) means that profits are likely to be lower this year, with a loss even possible for Q1. CI nonetheless retains its BBB- rating on this bond as unless the correction becomes considerably worse, the ability of the Company to meet its obligations in a timely manner should not be impaired. The outlook on the rating remains stable at present but will be reviewed in due course in the light of market developments.

THE BOND

Issuer:	Bayan Investment Company S A K
Amount:	KWD20mn
Maturity:	February 2010. However the borrower has the option to redeem to bond at par on or after the third anniversary of the issue.
Coupon:	
For years 1-3:	6.5% fixed
For years 4 and 5:	Central Bank of Kuwait Discount Rate plus 1.5%
Security:	None
Covenants:	Standard negative pledge Maximum leverage 0.75
Lead Manager:	National Bank of Kuwait
Fiscal & Principal Paying Agent:	National Bank of Kuwait
Clearance & Depository Facilities:	Kuwait Clearing Company

Use of Proceeds The main use of proceeds was initially to refinance the then overdraft outstandings and other short term bank borrowings. The intention was to produce a better match between the overall tenor of assets and liabilities. The short term lines available to the Company were however maintained to fund the trading book and for working capital purposes. Company policy is that debt to equity should not exceed 1:1.

Source of Repayment Bayan expect to build up cash reserves of KWD5mn or more by the time the bond matures. The balance of the funds required will come from the sale of liquid securities.

Security Position The parent company has no debt outstanding that is secured on the assets of the parent company. There are however loans totalling KWD22mn from two banks to the parent company which are secured on the two investment properties owned by Bunyan Real Estate Company, a 100% owned subsidiary.

NON-FINANCIAL FACTORS

CORPORATE STRUCTURE

The current organisational structure is fairly simple. The General Manager reports to the Chairman and, through him, to the Board. Reporting to the General Manager are two Deputy General Managers and, separately the International Investments Department. Reporting to one Deputy General Manager is the Local Investments Department and, to the other, finance and administration functions. At present the latter includes Accounts, Treasury, IT and HR and Administration.

There are however plans to update the structure. HRD International have been retained to design a new organisation chart and to make recommendations on human resources policies. In parallel the Company intends to engage either Ernst & Young or RSM International to establish a risk management function. Internal audit continues to be outsourced to Ernst & Young. An earlier updated organisation chart and description of job responsibilities devised by Ernst & Young have not been adopted.

REGULATORY SUPERVISION

The primary regulator for the investment company sector in Kuwait is the Central Bank of Kuwait. The regulatory regime in Kuwait includes regular on-site inspections as well as on-going off-site supervision. The Company submits a range of monthly and quarterly reports to the central bank.

As a quoted company, Bayan must also adhere to the rules and regulations of the Kuwait stock exchange. In terms of reporting, a range of quarterly returns are required. In addition, any purchases or sales of treasury stock must be reported immediately to the KSE.

INTERNAL CONTROLS

The internal audit function has been outsourced to Ernst & Young. Monthly internal audit visits are made and quarterly reports produced. CI has been provided with copies of these reports, which are comprehensive. Separate reports are produced for the various operational and business areas of the company as well as for IT and the back office. Management confirms that all of the important exceptions have been remedied.

The internal audit reports also include details on compliance with internal controls and procedures, as well as making recommendations for improvements in the latter. Internal controls and agreed operational procedures appear satisfactory. Although Bayan does not yet have a separate risk management function, this is seen as a priority area by management. The new organisation chart (see above) will include a separate risk management function.

Bayan has detailed and fully documented policies and procedures in place covering the main activities of the Company. CI has been provided with copies of these procedures manuals.

SUBSIDIARIES

Bayan had three consolidated subsidiaries and eleven unconsolidated subsidiaries as at end 2005. Two of the companies (Arkan Holding Company and Al Nour Holding Company) act as the names would suggest as holding companies for investments in other companies and subsidiaries. Both are 100% owned. The third consolidated subsidiary is the 100% owned Bunyan Real Estate Company.

Bunyan Real Estate Company This company acquired investment properties totalling KWD32.8mn during 2005 comprising a site on the Gulf Road and a site in Dasman. While the latter is likely to be sold on, Bayan plans to develop the Gulf Road site for a 20 floor office tower with limited retail space on the ground floor. The cost of the site was KWD20.3mn. At present the company is awaiting the necessary approvals, including a zoning change for both sites. The two sites are presently zoned for residential apartments. The company is also hoping to increase the approved density of the Gulf

Road site to allow the full 20 floors to be built. The independent third party valuation of the site on an existing zoning use basis is a rather lower KWD11.0mn. As a result a provision of 25% of the difference or KWD2.3mn was taken in 2005. The fair value of the Dasman site is KWD12.3mn.

Management is confident that both the re-zoning and a building density of at least 400% will be granted. On this basis management has calculated that the combined valuations would rise to somewhere in the region of KWD34.mn. If the approved ratio was as high as 800% (i.e. the full 20 floors for the Gulf Road site) the combined value could be as high as KWD47.2mn.

Al Batra Holding Company This company had a capital of KWD0.1mn as at end 2005. Bayan are however in the process of increasing the capital to KWD75mn via a private placement that will significantly reduce the stake held by Bayan (a similar process took place with Gulf Holding Company in 2005, reducing the Bayan stake to 11.57%). The company is to make real estate investments in Jordan. As the necessary government approvals for the planned investments have been received, consultants are currently preparing feasibility studies and market analyses.

Arkan Industrial & Mining Company (AIM) This is an Egyptian company. AIM is constructing a plant in 10th Ramadan City to produce frit, an intermediate input in the manufacture of ceramic tiles. The plant cost is estimated at around USD8mn, all of which will come from capital. Another EGP2.5mn has been spent in acquiring the land for the plant. As at end 2005, the capital of the company was the equivalent of KWD0.7mn. The plant construction is nearing completion and management are hopeful of starting test production in June 2006.

Arkan International for Construction Materials Company This is also an Egyptian company, with an investment of the equivalent of KWD0.5mn. The intention is to construct a plant to manufacture a wide range of building materials. The project is at the land acquisition stage.

Sawt Al-Ghad Company Bayan has entered into an agreement with a Lebanese FM station to operate an FM station in Kuwait. However the licence has yet to be granted. At this stage the investment is less than KWD0.3mn.

STRATEGIES

Bayan has built a successful record over the last few years on a fairly simple business model. This has been largely based on a series of core investment holdings in high quality Kuwaiti companies. Although this has meant some share-specific and sector concentrations evolving (in part because the prices of these companies have outperformed), this has (at least in the past) been mitigated by the blue chip nature of most of these holdings and the very liquid market for the shares concerned. More recently however the Company has broadened its range of activities and investments. It had been expected that this would begin with the establishment of additional managed funds but Bayan management has decided that there is greater potential in direct investment in real estate and in manufacturing on a private equity basis.

FUNDS

Currently the only fund managed by the Company is the Ea'mmar & Estethmar Fund; the other funds previously managed by Bayan have been closed. The fund is jointly-managed by Bayan and by Aerated Concrete Industries. The fund invests in real estate and in companies active in this sector. As at end 2005 the net asset value of this fund was KWD7.4mn.

PROSPECTS

Until very recently prospects appeared favourable, although certain vulnerabilities remained. In terms of revenues, nearly all income comes from the Company's own investments; fee and commission income is still relatively low although 2005 saw Bayan sharply increase fee income as a result of private placement activity. In market terms, much of the portfolio remains in Kuwait. Although all Kuwaiti investment companies suffer from this vulnerability, some have a somewhat higher level of

geographical diversification than Bayan. Even within Kuwait, Bayan's portfolio is more concentrated than usual and the Company may suffer for this, at least in Q1

Management is aware of these vulnerabilities, and has moved to diversify both the portfolio and revenue streams, including increasing activity outside Kuwait and, within Kuwait adding real estate and other direct investment activities. However the Company will remain vulnerable to further market corrections, especially in the near term as the new activities have yet to begin to make a significant contribution to revenues.

FINANCIAL ANALYSIS

The accounts are audited to International Accounting Standards by the Kuwait practice PricewaterhouseCoopers and by Al Bazie & Co (part of RSM International). The accounts are unqualified. The Company has also provided considerable additional financial information to CI.

ASSET COMPOSITION

Investments at fair Value through the Income Statement This is the largest asset class on the balance sheet, rising from KWD56.5mn to KWD83.2mn. Of the total, KWD80.9mn represented investments in Kuwaiti equities. Although this latter portfolio is reasonably well diversified in terms of industrial sector, there are significant concentrations in terms of individual stocks. The largest holding is KWD54.3mn while two others were in excess of KWD8mn. Apart from Kuwaiti equities there are smaller portfolios of foreign managed funds (KWD2.1mn) and equities futures (KWD0.2mn).

Although the larger holdings are in what CI considers to be high quality companies in terms of creditworthiness, such asset concentrations can make the company vulnerable to increased volatility at times when the markets suffer a correction, as at present.

Investments available for sale Once again the Company has provided CI with full details of holdings. This KWD47.4mn asset class includes a number of substantial core holdings of quoted equities of blue chip Kuwaiti companies in the banking, real estate and services sectors. Quoted Kuwaiti equities total KWD20.1mn. The unquoted local investments totalling KWD19.8mn include a KWD2.5mn investment in the Bayan's own fund and a KWD8.1mn holding in Gulf Holding Company. Foreign investments included KWD4.7mn in unquoted GCC investments and KWD2.7mn in non-GCC managed funds, most of which were private equity.

Investments in Unconsolidated Subsidiaries As at end 2005 there were eleven unconsolidated subsidiaries. Some were inactive and represented vehicles established for potential further diversification of activities. Four however are currently in the process of activation. For further detail see the **Subsidiaries** section in Non-Financial Factors. The aggregate investment in these unconsolidated subsidiaries was KWD2.8mn as at end 2005.

Investment Properties These assets with a book value of KWD30.4mn are held by the 100% owned subsidiary Bunyan Real Estate. Although the fair value was only KWD23.3mn Bayan management indicates that the company has already received offers for the two properties totalling KWD45mn in aggregate.

LIABILITIES COMPOSITION

Accounts payable Almost KWD4.8mn of the KWD7.5mn total represents amounts due to related parties. These in turn represent either the capital of inactive subsidiaries or the capital of active subsidiaries where plan construction has yet to begin plus a KWD1.8mn amount owed to Gulf Holding Co. A further KWD1.0mn represents taxes payable. Accrued interest payable was KWD0.9mn.

Funding Structure Apart from the KWD20mn bond, all funding facilities come from four Kuwaiti banks and totalled KWD43.9mn. Loans to the parent company are generally unsecured although two loans to the parent totalling KWD22mn are co-signed by Bunyan Real Estate Co. and are secured by a mortgage on the real estate owned by the latter. All lines are short term in tenor and are made up of a combination of overdrafts, revolving loan facilities and fixed term loans. Although the Company does not have a significant volume of unused bank lines, the liquidity position was satisfactory at end 2005 and dividend inflows for the year were KWD2.0mn. The dividend position in 2006 is perhaps less clear following the abrupt correction in the KSE that began in March; some companies may choose to trim their dividend payouts to conserve cash.

Capital Shareholder funds increased by 31.7% in 2005 to KWD98.3mn. Most of the increase came from an increase in retained earnings and statutory and voluntary reserves. However there was also a fair value reserve increase of KWD3.1mn and KWD2.0mn increase in paid in capital through an issue of bonus shares.

The capital base of the Company may however have been significantly affected by the impact of recent falls in the KSE. The full effects will not be known until Q1 2006 financials are available.

Profitability After showing a substantial loss in 2000, Bayan has been consistently profitable. The last three years in particular have been excellent ones for the Company. Not only did Bayan benefit from the general rise in the market but most of its core holdings are in companies which themselves outperformed the market in terms of total shareholder return. The situation in 2006 is very different. Although the companies which make up the bulk of the portfolio have themselves performed well in their core businesses, they too will have very probably been impacted by the fall in the KSE as they too have investment portfolios and key strategic holdings in certain companies. The market has appeared to also take this view, and as at mid March the falls in their share prices had exceeded the general fall in the KSE index. Unless the market recovers strongly, profit performance is likely to be much weaker in 2006.

In 2005 however performance was very strong. Although net profit rose by only 12.1% to KWD31.2mn this was largely a reflection of another very good performance in 2004. As in previous years the bulk of revenues of KWD39.8mn came from investment income. This totalled KWD36.4mn, up from KWD31.8mn in 2004. As stated earlier, within the 2005 total dividends were KWD2.0mn while a further KWD13.1mn came in the form of realised gains on the disposal of trading investments and available investments. Management fees were KWD3.4mn and came largely (KWD3.0mn) from the placement fees on the Gulf Holding Co. private placement. Other revenue streams were insignificant.

One of the strengths of Bayan is its fairly lean cost base. Although operating expenses rose by 16.5% to KWD2.4mn, this still represented only 6.43% of gross income. Staff costs were KWD1.1mn, of which KWD0.3mn represented bonus payments and only KWD0.6mn actual salaries. There is therefore scope for reduction in costs in times when revenues fall.

Cash Flow As it is an investment company, cash flow analysis has limited utility in the case of Bayan.

Leverage and Liquidity Although leverage again increased in 2003, it remained satisfactory at 0.73. Liquidity was also satisfactory. Although the current ratio reduced due to an increase in longer term investments and the application of IAS39, it remained at an acceptable 1.74%. However it is almost certain that the liquidity position will have tightened considerably this year in view of the fall in the KSE and the consequent effect on the value of Bayan's current assets base. CI would prefer to see the proportion of longer term money in the funding base increase in view of the changes in strategy which have seen Bayan moving into real estate and into direct private equity investments in Egypt and elsewhere.

Funds under Management These rose from KWD17.4mn at end 2002 to KWD46.4mn at end 2003 and then to KWD58.5mn at end 2004. The figure at end 2005 was KWD76.9mn, of which KWD69.3mn were client portfolios with the balance representing the single managed fund.

FORECASTS FOR 2006-10

ECONOMIC ENVIRONMENT

Effect of Current and Projected Economic Conditions Given the structure of the economy, performance still depends on the prosperity of the oil and gas sector. Although Kuwait has large oil reserves, reserves and supplies of gas are limited. This is a potential problem, as gas is needed for the growing petrochemical industry and for electricity generation. There are plans to import gas from Iran and from Qatar. In December 2004, Kuwait and Iraq agreed a 200mn cubic feet per day contract. This will come in two phases. The first 35mn cubic feet per day started arriving in October 2005 with the remainder coming on stream in 2007. Increased supplies of gas would allow Kuwait to reduce its current use of oil in electricity generation, desalination and petrochemicals, freeing up an estimated additional 100,000bpd of oil for potential export.

Oil production is much more important for Kuwait. The country currently has a sustainable production capacity of around 2.5mbd. However, currently on-going expansion projects should raise capacity to 2.7mbd. The government has a longer-term aim of raising output capacity to a possible 5mbd by 2020. Part of this increase is intended to come from an increase of output at five northern wells from 0.6mbd to 0.9mbd using foreign oil company expertise. This project would cost around USD7 billion. Actual production levels averaged 2.04mbd in 2001 and (after OPEC production cuts) 1.89mbd in 2002. In the run up to the start of the Iraq war, production was raised to 2.1mbd in Q1 2003 and the average for the year as a whole was 2.17mbd. In 2004 output increased further to an estimated level of around 2.34mbd and current production is around 2.5mbd. In December 2005 plans were announced that would see Kuwait spending over USD40 billion on the oil sector over the next 15 years, including projects that would raise output to 4mbd. The plans include a large new refinery and a series of petrochemical projects.

Kuwait was also an early investor in refinery capacity. Before the 1990 Iraqi invasion, Kuwait had refinery capacity for 820,000 bpd, most of which was exported. During the occupation, much of this capacity was badly damaged but over the subsequent years Kuwait again rebuilt capacity to 900,000 bpd. A number of projects are underway to update and improve refining capacity under a KWD900mn five-year plan. Construction of a fourth refinery is under consideration. In addition to refining, Kuwait has also entered the petrochemical market. The Equate I complex which came on line in 1997 includes a 650,000 metric tonnes per year ethylene cracker, two polyethylene units with an aggregate annual capacity of 450,000 metric tonnes and a 350,000 metric tonnes per year ethylene glycol unit. Construction of an Equate II plant is now getting underway while Petroleum Industries Corporation is to build a USD1.4 billion aromatics plant. Equate II will have the annual capacity to produce 850,000 tonnes of ethylene, 600,000 tonnes of ethylene glycol and 450,000 tonnes of polyethylene.

GDP

Once again the oil sector dominates, making up 46.6% of GDP in 2003. The largest component of non-oil GDP is made up of government contributions, partly in the form of subsidies and what is believed to be expenditure on other sensitive state-related services. However, it is important to note that the government's share in overall GDP is higher than as reported in official statistics. Indeed, the private sector is defined by the central bank as 'individuals, institutions and companies belonging to private, joint or public sectors, including public institutions with independent budgets'. Accordingly, it is estimated that the state probably contributes directly and indirectly to nearly three-quarters of GDP.

Figures for 2004 are not yet available. However research estimates by one Kuwaiti investment house show a GDP of KWD14.3 billion (USD48.5 billion). This translates into a growth rate of 14.9%. For 2005 rates of growth are likely to be much lower – the gains from higher oil prices are already in the numbers. Even if oil prices do not slip, the room for increasing output is limited by technical factors as well as OPEC quota. The estimate is for growth in GDP of just 2.9%.

FOREIGN TRADE

Kuwait, by virtue of its huge oil reserves and high oil exports, normally derives large surpluses on its balance of trade. In times of relatively high oil prices, the trade balance soars but the reverse is true during periods of low oil prices. The trade surplus reached its earlier peak in 1996 (USD6.5 billion), with exports covering imports to the tune of 178%. The surplus also stayed high in 1997 as the full effect of lower oil prices started showing only the following year. With oil prices crashing in 1998, the trade balance deteriorated significantly. Similarly, the recovery in oil prices following the March 1999 OPEC agreement led to a much higher surplus in 1999 and a new record surplus in 2000. A smaller quota and lower prices reduced the level of surplus in 2001 and again in 2002 but it still remained large in historical terms. The rise in oil prices in 2003 pushed oil export proceeds up by 32.5% and helped to raise the trade surplus by over 50%.

If 2003 was good, 2004 was even better. Oil prices rose to record levels, as did output with the relaxation in production limits imposed under OPEC agreements. Although the export price for Kuwaiti crude (at around USD34 per barrel at present) is rather lower than the headline numbers for WTI or Brent, the percentage increase has been similar. As a result the trade surplus rose to KWD4.55 billion. Efforts by the government to increase non-oil exports have yielded limited results and although such exports have grown, they remain limited in volume terms. The emphasis has been on petrochemical products, particularly through the Equate petrochemical complex that opened in late 1997. This was reflected in the 40% rise in the value of non-oil exports in 1998. The strong upturn in the petrochemical cycle has helped to raise the value of these exports and this has been reflected in the higher non-oil export figure in 2003 and the KWD724mn figure for 2004. Further expansion in the petrochemical industry in Kuwait should help to increase non-oil exports further in coming years. Re-exports to Iraq (a significant trade before the Iran-Iraq war) could also take on added importance should security conditions improve in that country.

Export prospects for 2005 are excellent, as are those for 2006. For the first three quarters of 2005 the aggregate trade surplus was KWD5.67 billion. The international benchmark oil prices remain firm, driven by strong and sustained demand from India and China in particular. However output may have to be trimmed at some stage in 2006 if OPEC is to maintain its firm control on pricing. There is also always a possibility that oil prices may soften later in the year although this is seen as being unlikely on current trends. Non-oil exports should also remain firm. Imports are expected to grow however as the heavy spending phase of a number of large projects arrives. Despite this, a trade surplus in the region of KWD7.0 billion remains the likely outcome.

The current account balance fell in both 2001 and 2002 from the record high of KWD4.5 billion in 2000. The 2001 surplus was KWD2.6 billion while that for 2002 was KWD1.3 billion. Even at this reduced level it was equivalent to 12% of GDP. Apart from the reduction in oil export receipts, other contributing factors were higher imports, an increasing deficit on the services account and much lower investment income. The latter dropped from KWD2.1 billion in 2000 to KWD1.5 billion in 2001 and then again to KWD1.0 billion in 2002. Performance in 2003 was much stronger, as might be expected with higher oil revenues. The current account surplus rose to KWD2.3 billion or 36% of GDP. Performance was even stronger in 2004 with a current account surplus in the region of KWD5.57 billion.

PUBLIC FINANCE

Kuwait has consistently posted a fiscal surplus every year since fiscal 1998-99. This has been despite budgeting on the basis of a substantial deficit every year. The reason is that budgets were (until the forthcoming financial year) based on an oil price of USD15 for Kuwaiti export crude. Much higher real prices and annual shortfalls in actual spending explain the large differences. The surpluses for 2002/03 and for 2003/04 were KWD1.3 billion and KWD2.2 billion respectively.

It should again be emphasised that the budget deficit that was predicted for 2004-05 is that for the approved budget. They were based (as for previous years) on an oil price rather lower than the actual price at USD15 and therefore once again substantially understate oil income. The preliminary figures for the actual out-turn are for a net surplus before contributions to the Reserve Fund for Future

Generations (RFFG) of KWD3.90 billion compared to a budgeted deficit of KWD2.34 billion. This figure is based on total revenues of KWD8.85 billion and expenditures of KWD4.95 billion. Of revenues, oil accounted for KWD8.1 billion, up 32% on the previous fiscal year. Non-oil revenues were a little lower at KWD749.3mn due to lower UN Compensation receipts; without this factor, non-oil income would have risen by 12%. The above figures are before allocations to the Reserve Fund for Future Generations (RFFG). The government is obliged to transfer 10% of oil income into this fund. The percentage may soon be increased to 15%.

The draft budget for the current fiscal year was prepared on the basis of an oil price of USD21. While a little more realistic than the USD15 used in the past, it is still likely to underestimate the actual prices that Kuwait achieves given the current oil prices. Under the budget, oil income is forecast at KWD3.9 billion and total income at KWD4.6 billion. Expenditure is set at KWD6.9 billion leaving a deficit of KWD2.3 billion. In reality, CI expects another budget surplus, although the level is still uncertain. After eight months of the financial year (i.e. end November 2005) total revenues were KWD9.19 billion and expenditures KWD2.95 billion. The surplus before contributions to the Reserve Fund for Future generations was KWD6.24 billion (after RFFG KWD5.32 billion), making a surplus for the fiscal year as a whole now certain although expenditures tend to rise later in the fiscal year. The size of the eventual surplus will depend on the level of oil prices during the remainder of the period as well as output levels. So far prices have been firm with the export price for Kuwaiti crude peaking at USD52.3 per barrel in August 2005 and still being above USD50 at year end. The average export price during the previous fiscal year was USD35.20. For calendar 2005 the average had risen to KWD47.3. Output is currently 2.5mbd as against the OPEC quota of 2.247mbd. Using an average oil price of USD49.6 per barrel oil revenues would be in the region of KWD12.6 billion and total revenues KWD13.3 billion. If expenditures are taken as per the government budget at KWD7.2 billion, this would leave a surplus of KWD6.0 billion before contributions to the Reserve Fund for Future Generations of KWD1.3 billion. In reality, the government usually fails to spend its full budget allocation and the eventual surplus is therefore expected to be around KWD200-300mn higher.

For the fiscal year 2006-07 the government has again raised the oil price basis, this time to USD36 per barrel. The draft budget (which has still to be approved) provides an estimate of oil revenue of KWD7.83 billion*, representing 90.9% of total income. Non-oil revenue is estimated at KWD0.78 billion but as always this excludes very significant investment income streams. On the expenditure side salaries and other personnel-related costs are budgeted at KWD2.09 billion. Goods and services expenditure is set at KWD1.42 billion. Construction was set at KWD1.20 billion. Transport was set at KWD0.13 billion with miscellaneous other expenditures at KWD5.49 billion. Overall spending is set at KWD10.1 billion which includes a KWD2.03 billion contribution to make up passed missed payments to the Public Authority for Social Security. A deficit of KWD1.49 billion is forecast.

While it is hard to be certain about either oil prices or output levels over the next fourteen months, it would appear likely that both the export price for Kuwaiti oil and the output level will again be somewhat higher than the figures used in the preparation of the budget. Using an output level of 2.5mn bpd and an average price of USD45, oil income rises to over KWD11.5 billion, resulting once again in a surplus rather than the forecast deficit.

** This oil income forecast would also seem to factor in a reduction in output levels back towards Kuwait's official OPEC quota.*

OUTLOOK

Following the conclusion of the Iraq war, and despite the on-going lack of security in that country, Kuwait continues to be in an enviable position. Contrary to earlier fears, the war has not been followed by a softening of oil prices. On the contrary, supply constraints and high and rapidly growing demand from Asia had led to a period of sustained very high oil prices. As a result, there has been no need to reduce OPEC production quotas and Kuwait is therefore benefiting from both relatively high output levels and firm prices. Although the previously significant flows of UN compensation monies have largely ceased, Kuwaiti businesses remain in a good position to benefit from the reconstruction process in Iraq as it is the logical logistics centre for much of the supply effort, especially for southern

Iraq. This continues to be the case despite the slow pace of reconstruction and economic progress in Iraq

Despite the current favourable conditions, some negatives remain. The country continues to depend heavily on crude oil for its survival and only limited efforts have so far been made to diversify the economic structure. Instead, the focus has been on building long-term investments outside the country, which become a vital source of revenue when oil revenues are soft. Moreover, the country continues to offer its citizens a particularly generous welfare system, which it has so far been unwilling to streamline due to political factors. Consequently, there is not much flexibility in terms of cuts in the current expenditure side of the budget. For the coming year, this will continue to be something of limited immediate importance, as the economy should again perform strongly. Nonetheless, all markets are cyclical and continued strong oil prices cannot be assumed in the medium term. Demographics are a further cause of concern. With almost 42% of the national population under the age of 15, there is likely to be a surge in the number of young nationals entering the jobs market over the next five years. With almost the entire national workforce employed by the public sector, there is clearly very limited capacity to absorb these new entrants to the jobs market. Quite where the jobs will come from remains to be seen unless there are much more effective efforts made to develop a meaningful private sector (and to get the private sector itself to employ more Kuwaitis).

Other areas that might cause problems in the future are the stock exchange and consumer finance. After a poor period from 1998 to 2000, share prices subsequently rose strongly. The general index rose from 1348.1 at end 2000 to 1709.4 at end 2001 and then again to 2375.3 at end 2002. The market then more than doubled in 2003. Although performance was a little less frenetic in 2004, the rise was 33.8%. Strong conditions persisted into 2005, and after some initial corrections during Q2, the market began to again probe new highs. As at end December the KSE had risen to 11,445, an increase of 78.8% since the beginning of the year, albeit a little off the all time high of 11,962 reached a few weeks earlier on 4th December. In retrospect this may prove to have been the peak. Although stock market performance was reasonable in January and February, the KSE index was only slightly ahead of the year end 2005 level for most of the period. This was then followed by what was a serious correction in March. As at March 15th the KSE index stood at 9,939, a fall of 13.16% on the year. The full effects of this correction will not become apparent until companies begin to release their Q1 financials. Given that many Kuwaiti companies derive a significant proportion of their revenues from investment activities, the impact may be large. There is therefore a danger that poor Q1 results for non-investment companies (as well as the expected lower results for investment companies) may prompt further selling.

Note: The KSE is not a weighted index. The change in the various weighted indices provided by a number of investment companies may be somewhat lower than the headline rises in the KSE.

FINANCIAL FORECASTS

BALANCE SHEET

Although the forecasts run out to 2009, the following analysis will concentrate on 2006 and the earlier part of the succeeding period. Visibility declines quite sharply for companies in the investment company sector in the Kuwaiti market, especially if the bulk of earnings come from the proprietary portfolio rather than from investment banking, asset management or brokerage.

The Company has prepared these forecasts on the assumption that (a) the recent correction in the Kuwait market will be limited in size and duration, (b) that balance sheet growth will continue and (c) that any Q1 losses due to the market correction will be made up by placement fees earned on pending transactions in other GCC and MENA markets. CI is somewhat less sanguine that this will in fact prove to be the case. The following analysis should therefore be read with some caution.

The forecasts are based on parent only accounts, and therefore treat the Bunyan Real Estate Co and the other consolidated subsidiaries as investments.

ASSETS

Composition 2006 Bayan expects total assets to grow to KWD195.7mn by the end of this year, an increase of 16.7%. The main areas that are expected to see increases are the trading securities portfolio and what are termed *Other Receivables*. These are in turn mainly made up of monies advanced to Bunyan Real Estate Co to allow it to purchase sites and, in due course move towards development. This asset class is expected to rise to KWD30.1mn this year while trading securities are expected to increase to KWD103.5mn. There are no substantial increases expected in the investments in the other subsidiaries. As Bunyan is not consolidated into these forecasts, there are no holdings of investment properties. Core holdings (non-trading) are forecast at KWD21.1mn while direct investments are forecast at KWD20.6mn. Net purchases of investments are expected to be only KWD2.5mn in contrast to the large KWD39.0mn in 2005 (although most of the latter related to Bunyan). International investments are expected to remain fairly low at just KWD10.1mn.

Composition in succeeding periods Given current strategies, a similar pattern is expected for future periods. Total assets are expected to rise to KWD225.3mn in 2007 and then to KWD256.7mn in 2008. By 2009, immediately before the bond is due for repayment, total assets are expected to have reached KWD270.2mn. The cash element of the balance sheet is expected to remain above KWD6mn for every year until the repayment of the bond.

Capital Management see no need to raise additional capital during the forecast period. However shareholders funds are expected to rise steadily via retentions. Dividend distribution from 2006 onwards is forecast at a steady KWD0.025 per share.

Liabilities and Leverage At the time of the original rating, Bayan expected to have a rather smaller balance sheet than is currently the case. As real estate investment was not forecast, the associated borrowing was not forecast either. In the event borrowings including the bond were KWD63.9mn at end 2005 rather than the KWD27.9mn that was originally forecast. The difference is however largely due to Bunyan Real Estate Co and Bayan do not see borrowings at the parent company level increasing at all during the rest of the forecast period.

Leverage at the parent level was 0.86 at end 2005. The forecast leverage levels for the remainder of the forecast period are as follows:

2006	0.66
2007	0.54
2008	0.44

It should however be pointed out that these calculated ratios are based on the achievement of what CI sees as rather challenging profit forecasts (see below). While achieving the targets is not impossible, it will be perhaps difficult. If this is the case, growth in retained earnings and therefore shareholders' funds may lag the levels seen in the forecasts.

No ratio is calculated for 2009 as the forecasts show the bond balance as zero. In reality, Bayan management currently intend to let the bond run to maturity in February 2010. However they currently plan to have already collected the full KWD20mn for repayment by the end of 2009.

Liquidity Given the nature of the forecast investment portfolios, effective liquidity will remain high. Although much of the overall portfolio will remain in the form of core holdings in a relatively limited number of companies, these are companies with a large market capitalisation and a very liquid market for their shares.

Profitability This is an area where recent market conditions have created considerable uncertainty, particularly in the short term. The forecast prepared by management indicates a net profit of KWD35.0mn this year, up from KWD31.1mn in 2005. However the current correction in the KSE has certainly put a large dent into Q1 earnings. Although there still remains the best part of two weeks for the market to recover, there is no sign of a sustained rally yet and conditions are similar in nearly all

the other GCC markets. If prices remain at current levels, Bayan is likely to breakeven at best for the quarter.

As they stand, the forecasts show KWD12.4mn of total revenues of KWD18.8mn to come from gains on sales of Kuwaiti securities with a further KWD1.3mn coming from gains on sales of international securities. Unrealised gains on investments are forecast at KWD23.0mn. Given the current state of the Kuwaiti market, these numbers look challenging. Set against that however is the potential increase in the value of the investment in Bunyan Real estate should the requested re-zoning be approved, particularly if the increased build density applications are also granted. Fee income of KWD3.6mn covers both asset management income and placement fees earned.

The forecasts show rather smaller increases in profits in 2007 and subsequent years with net income rising by at little under KWD2mn in each year. As with 2006, it is difficult to ascertain the achievability of these targets under current market conditions.

Cash Flow As Bayan is an investment company, analysis of cash flow statements is of limited utility.

Risk Factors As a pure investment company, the main risk to Bayan was (at the time of the original rating) was seen to be a large and sustained fall in the KSE. Although the Company does have some international exposure, this was less than 12% of the balance sheet at that time. This risk was “priced into” the rating assigned by CI. In the event, Bayan enjoyed two very good years in 2004 and 2005 and this boosted shareholders funds considerably. Thus although the current market correction may prove painful in terms of earnings, it would have to proceed much further before it threatened the Company’s ability to service its obligations in a timely manner.