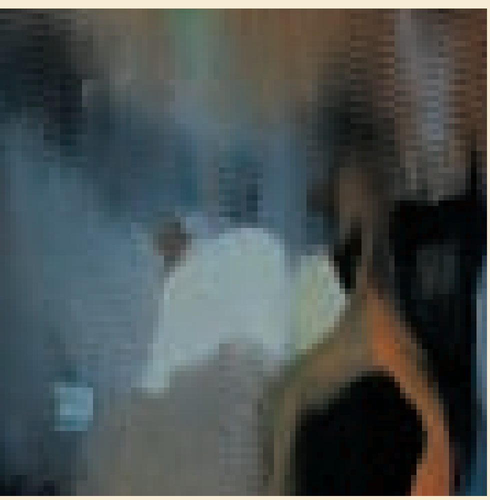
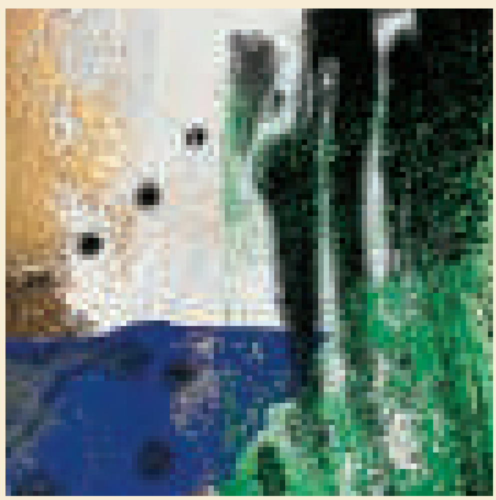
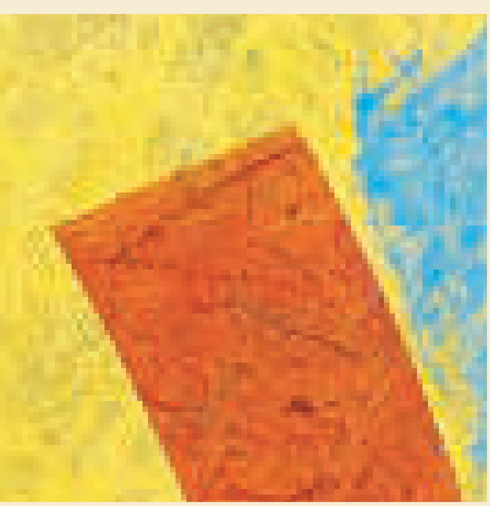
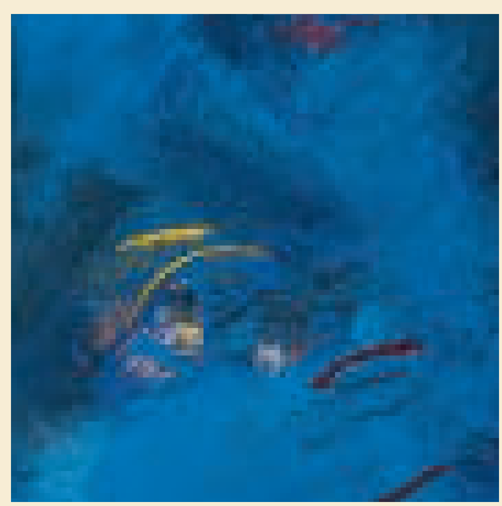
مؤسسة الخليج للإستثمار
Gulf Investment Corporation

Annual Report and Accounts 2005



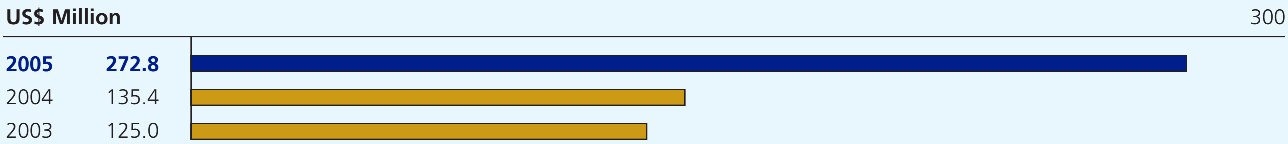


Mission Statement

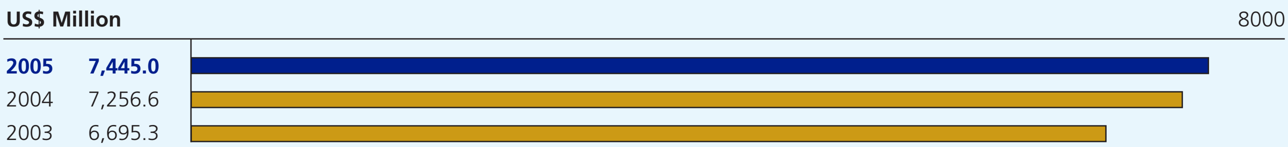
Gulf Investment Corporation (GIC) is a leading financial institution offering a comprehensive range of financial services to promote private enterprise and support economic growth in the Gulf Cooperation Council (GCC) region.

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

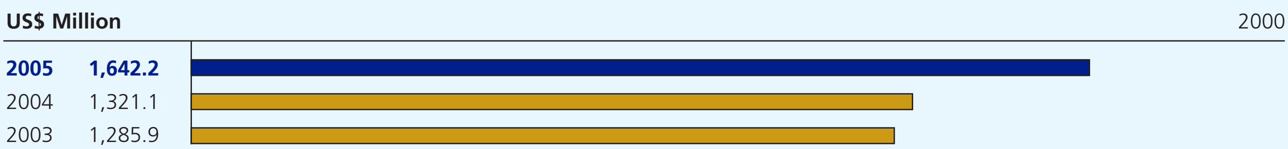
Net Income



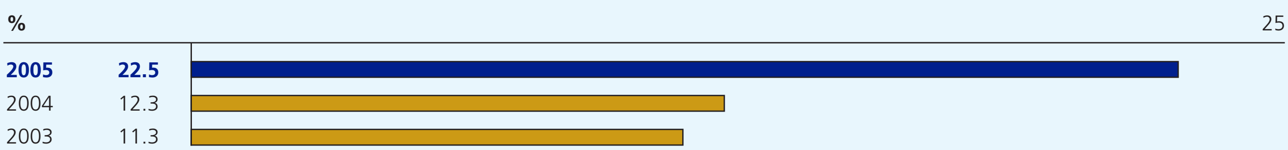
Total Assets



Shareholders' Equity



Return on Adjusted Shareholders' Equity



(US$ million)	**2005**	2004	2003
For the year			
Net Interest Income	**20.6**	61.1	91.0
Other Income	**309.1**	117.4	87.2
Operating Expenses	**45.5**	36.5	30.2
Net Income	**272.8**	135.4	125.0
At year end			
Total Assets	**7,445.0**	7,256.6	6,695.3
Trading Securities and Managed Funds	**1,129.1**	596.3	411.9
Investment Securities	**4,062.0**	4,636.1	4,325.9
Loans and Credit Funds	**479.7**	491.5	445.8
Deposits	**2,061.1**	2,357.3	1,904.0
Shareholders' Equity	**1,642.2**	1,321.1	1,285.9
Selected Ratios (%)			
Profitability			
Return on Paid-up Capital	**36.4**	18.1	16.7
Return on Adjusted Shareholders' Equity	**22.5**	12.3	11.3
Capital			
BIS Ratios			
- Total	**25.6**	24.0	29.2
- Tier 1	**22.9**	22.2	27.9
Shareholders' Equity as a % of Total Assets	**22.1**	18.2	19.2
Asset Quality			
Loans & Credit Funds as a % of Total Assets	**6.4**	6.8	6.7
Marketable Securities as a % of Total Assets	**55.9**	64.3	64.7
GCC & OECD Country Risk as a % of Total Assets	**99.4**	99.2	99.2
Liquidity			
Liquid Assets Ratio	**78.6**	81.2	79.5
Productivity			
Operating Income as Multiple of Operating Expenses	**7.2**	4.9	5.9

Contents:

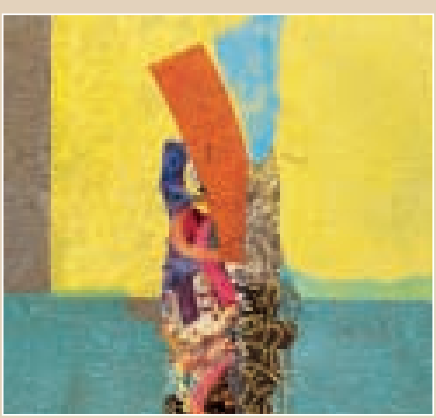
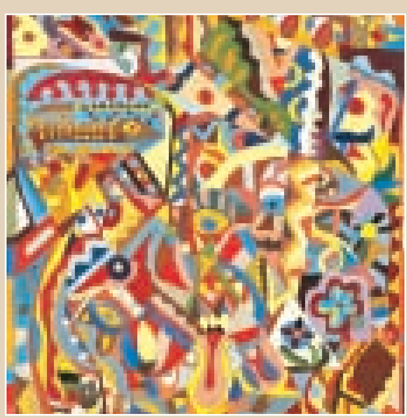
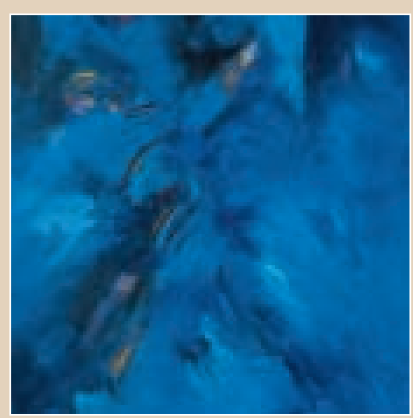
To illustrate this year's Annual Report, we have selected six paintings, one from a national artist in each of the countries that comprise the GCC region.

As a collection, the paintings show common elements, depicting an underlying synergy and cultural harmony, ultimately reflective of the region as a whole. Individually, each painting celebrates the independence and unique diversity inherent to the artist's own style and country.

These approaches closely mirror GIC's way of conducting business in the region and are also representative of GIC's ownership and heritage.

GIC believes in developing local economies and in empowering GCC nationals through investment. We are proud to be able to showcase these impressive talents in this report.



State of Qatar

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

H.E. Dr. Hussain Al-Abdulla §
Deputy Secretary General for Investment Affairs
Supreme Council for Economic Affairs and Investment

State of Kuwait

H.E. Dr. Yousef Hamad Al-Ebraheem**
Deputy Chairman
Advisor to the Prime Minister of the State of Kuwait

H.E. Mr. Abdulmohsen Yousef Al-Hunaif §
Chairman & Managing Director
Industrial Bank of Kuwait

United Arab Emirates

H.E. Mr. Shabib Ahmed bin Rashed bin Shabib*
Director of Industrial Development Department
Ministry of Finance and 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 Officer
Economic Development Board

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

Kingdom of Saudi Arabia

H.E. Mr. Ibrahim M. Al-Romaih *
Vice Chairman
Capital Market Authority

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 *
Undersecretary of Financial Affairs
Ministry of Finance

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

Senior management

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

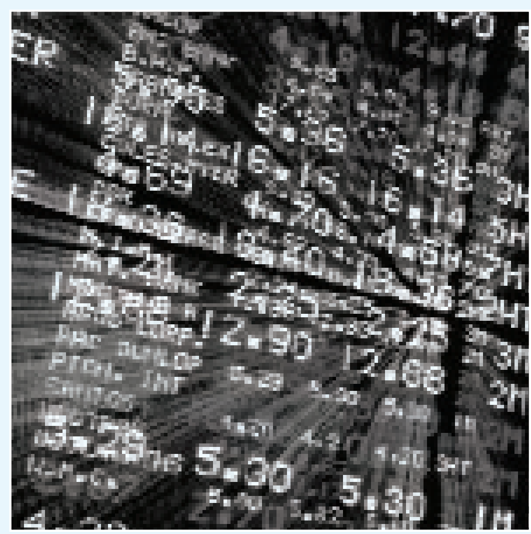
Mr. Rashid Bin Rasheed
Deputy General Manager &
Head of Finance & Administration

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

Business Highlights





Profits for the year doubled

to US$272.8 million with revenues from direct investments increasing fivefold.

Continued diversification of income,

resulting in a more balanced profits picture, with net income from the Principal Investment Group increasing substantially and fees and commissions higher by 31% over 2004.

Credit rating upgrades:

Moody's elevated GIC's rating by two upgrades from Baa1 to A2. Standard and Poor's has also upgraded GIC to A-. The rating upgrades were based on being a sound high quality credit counterparty, supported by increasing profitability and a clear strategy.

Surge in activities in all business segments:

- Eleven new investments in projects and equity participations that brought the total to US$736 million from US$435 million in 2004, representing an increase of 69%.
- Five new investment products that are offered to an expanding client base in the GCC.

H.E. Shaikh Fahad bin Faisal Al-Thani
Chairman

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 2005.

2005 was an outstanding year for GIC. Significant advances across all spheres of business led to a doubling of net income, which reached US$272.8 million, the highest ever in the corporation's 22 year history. I am pleased to report that this is the fourth consecutive year of income growth, once again validating that GIC's re-vitalized strategy and focus on the GCC region has been extremely successful. The 100% year-on-year growth in net income during 2005, was driven primarily by a substantial increase in profits from GIC's principal investments portfolio – the core business of the corporation. In addition to returns that are booked and reflected in the statement of income, there has been significant appreciation in the value of certain listed project investments, which are yet unrealized. Moreover, there has been a sharp rise in the intrinsic value of some of our unlisted equity participations, a result of the regional economic expansion and increased global demand within certain sectors. Strategies are being developed to unlock this value.

Performance on the basis of shareholders' funds was robust as well, with return on adjusted shareholders' equity rising to 22.5% from 12.3% in 2004, and return on paid up capital reaching approximately 36.4%, more than twice as that of the previous year. The corporation continued its strategy of planned growth, with overall assets rising by US$188 million during the year to reach US$7.4 billion.

In line with our corporate mission and strategic objectives, the corporation continued to concentrate on its regional expansion program, focusing on principal investment projects and the capital markets within the GCC countries. With our in depth knowledge of the local business environment and strong networking capabilities within the private and public sectors, we are striving to play a key role in the economic development of the region, and simultaneously benefit from it.

Over the past few years GIC has played a vital role in promoting private enterprise within the region by initiating and or participating in the setting up of large scale projects across a range of sectors including Power, Telecommunication, Metal, Financial services and Petrochemicals.

With the objective of achieving adequate diversification, the corporation's expo-sures to the GCC region are balanced by investments in global markets spread across several asset classes and investment themes. Most of these core portfolios also performed well during 2005, contributing to overall profits.

The successful execution of our liquidity risk management initiatives was another key achievement during 2005. In April 2005, GIC enhanced its long term funding source through a US$200 million, 5 year syndicated loan program. This was followed up with another US$500 million, 5 year MTN issue in mid 2005. I am proud to say that, in both instances, GIC received very positive responses, reflecting the high level of confidence the corporation enjoys with regional and international investors.

The corporation's strong and consistent performance in the recent past, its robust risk management skills and solid capital position is reflected in the upgrades during 2005, by both the premier international rating agencies. Moody's upgraded GIC's long-term deposit and senior unsecured debt ratings to A2 from Baa1, an enhancement of two notches, while Standard & Poor's upgraded our long term ratings to A- from BBB+. In addition to having a positive impact on our funding costs, these upgrades will further enhance GIC's standing as a high quality business partner. We view such ratings as an external validation of our business model and will strive towards achieving further enhancements.

GIC remains to be one of the most strongly capitalized financial institutions in the region. Total shareholders' equity rose by approximately 24% to reach US$1.6 billion at the end of 2005. The strong growth in profits, coupled with significant enhancement in asset values contributed to this boost in the capital base.

On behalf of the Board of Directors, I would like to express my appreciation to the management and staff at GIC for a commendable performance during 2005. With its solid capital position, excellent human resource 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 environments. I see a bright future for GIC. The Board will continue to play a vital role in providing strategic guidance and support to the management at GIC.

The corporation will continue to focus on developing the regional economies, particularly with regards to playing a key role in integrating the GCC economies and creating synergies. In the medium term we envisage having a presence in each of the GCC countries and developing a robust network that has a pan-GCC coverage.

I take this opportunity to thank H.E. Mr Abdulmohsen Yousef Al-Hunaif, Undersecretary, Ministry of Finance, State of Kuwait, for his valuable contributions as a member of GIC's Board of Directors.

H.E. Shaikh Fahad bin Faisal Al-Thani
Chairman

Gulf Investment Corporation capped the five year period as a stand-alone institution, subsequent to the sale of GIB in 2001, with a record performance in 2005. GIC scaled new heights in 2005, posting a net income of US$272.8 million, a year-on-year growth in excess of 100%.

In early 2001, the GIC board authorized the divestiture of its principal subsidiary Gulf International Bank (GIB) at the bank's carrying value as of year-end 2000. Following this sale, GIC initiated several focused and well-defined action plans targeted at diversifying and enhancing revenues, increasing efficiency through management of expenses, and phased expansion of operating businesses. The performance and results achieved since then stand testimony to the success of this strategic revitalization.

Highlights of the past five years

The corporation has performed well over the past five years. Net income more than tripled during this period, with an increase in every intervening year. The boost to our bottom line resulted from a risk-managed expansion of the balance sheet, which grew by approximately 134% to reach US$7.4 billion by year-end 2005. The portfolio of project investments, which more than doubled in size during this five year period, was a key contributor to profit growth. Such GCC based principal investments form an integral part of our corporate goal and we will continue to pursue similar viable investment opportunities, which promote private enterprise in the region. As mentioned earlier, profits and returns have kept pace with our expansion program, as is reflected in the healthy growth in ROE ratios. Return on adjusted shareholders' equity increased from 8.3% in 2001 to 22.5% in 2005, while return on paid up capital rose from 11.4% in 2001 to 36.4% in 2005.

Prudent risk management has been a cornerstone of our growth strategy. During this period, our financial targets have been achieved by managing the various forms of associated risks and maintaining a strong capital position. Total shareholders' equity increased by a multiple of almost 1.5 times to reach US$1.64 billion in 2005.

This rise in the capital base is in addition to paying dividends, over the past five years, amounting to approximately US$580 million or 77% of paid up capital. That is, in terms of value added to shareholders, this aggregates to approximately US$1.1 billion. Our strong capital position is reflected in the healthy capital ratios, which by far exceed the minimum regulatory requirements. It is gratifying to note that our unique business model, strategic focus and performance have been validated by international rating agencies, as reflected in the multiple upgrades to GIC's credit ratings provided by Moody's and Standard & Poor's.

Principal Investments

2005 was a significant year for the principal investment activity, both in terms of revenue generation and business expansion. During the year, net income from this activity, including dividends and share of profits, reached US$126.8 million, a fivefold increase over the income posted in 2004. Continuous strategic management of the invested companies, coupled with the positive growth momentum within the GCC economies, contributed to the higher returns. GIC has adopted a dynamic approach to managing its projects portfolio, seeking to exit investments which have little potential for further value addition. It is worth emphasizing that profits booked exclude substantial unrealized gains arising from the higher valuations of certain quoted projects. Moreover, the real economic value within some of our unquoted principal investments is quite significant and is not reflected in the financial statements. We are in the process of developing strategies that will enable us to unlock this value and create resources for further deployment.

Mr. Hisham Abdulrazzaq Al-Razzuqi
Chief Executive Officer and
General Manager

During 2005, the principal investments team was successful in expanding and diversifying the overall portfolio as well. Assets grew by approximately 70% during the year, reaching US$736.2 million at the 2005 year end. In addition to augmenting our interests in certain existing projects, fresh investments were made in eleven new projects. The team successfully concluded the shareholder agreement in United Steel Company (USC) with strategic regional partners who are leading players within the steel sector. GIC conceived and led the development of this US$230 million project based in Bahrain, and has committed to invest US$24 million, representing 30% of authorized capital. Within the Telecommunication sector, GIC has created a special vehicle, Investel Holdings, which is based in Bahrain and will form a holding company for our key interests in the telecommunication sector. Petrochemicals was another sector that grew within our portfolio during 2005. GIC more than tripled its investment in National Petrochemical Industrialization Company (NPIC), by participating in its capital increase aimed at facilitating the company's expansion program. Within the same sector, GIC made a fresh investment in Yanbu National Petrochemical Company, an affiliate of SABIC, based in Saudi Arabia.

Another major investment executed in 2005 was the acquisition of a 25% stake in Jeddah Cable Company, a manufacturing facility producing a range of quality products for power transmission and distribution. During 2005, GIC partnered with and made strategic investments in several other GCC based projects within the textile, paper, manufacturing and financial services sectors.

Although, investments were made in 2005, for most, pre-investment analysis and project appraisals had begun much earlier. The underlying philosophy within our principal investment activity has always been the same: detailed fundamental analysis, strict financial discipline and adequate post investment monitoring. The benefits of this rigorous approach are reflected in the enhanced performance of most of our older projects.

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

The corporation's Global Markets business group manages a diversified set of portfolios in an array of different asset classes and investment themes that comprise investments ranging from plain vanilla bonds and equities to structured finance, private equity, market neutral, hedge fund and other alternative asset classes. This business group is also responsible for asset management in the GCC capital markets – both for proprietary and client portfolios.

Unlike in the previous years when interest rate spread income formed the bulk of global markets revenues, in 2005 it was the trading book that generated significant gains. With the increasing interest rate environment narrowing spread income from our international debt portfolio, the decision to realign resources into other diversified sources has kept us in good stead. The move to focus on the GCC capital markets paid off handsomely in 2005, with the GCC equities desk posting a fivefold increase in profits. Our GCC capital markets team have once again proved that diligent fundamental analysis and detailed market research are always rewarded. Leveraging our expertise in this area, the team launched several new products attracting regional and international investors. GIC has successfully marketed debt and equity products that have a pan-GCC coverage, contributing to the approximately 30% increase in fee based revenue.

Further enhancing such income will be a priority for the global markets team in the coming years. In this regard we have teamed up with reputed international financial institutions to engineer several new investment ideas, including structured finance products, capital guaranteed vehicles and alternative asset & hedge fund strategies.

The corporation's investment in international private equity funds has also performed well during the year, registering a year-on-year profit growth in excess of 65%. These funds invest in leveraged and unleveraged acquisitions, privatizations, recapitalizations, rapidly growing companies, expansion financings, turnaround situations, and other special equity situations. Revenue from the portfolio of alternative assets and hedge funds also rose during the year, providing low risk income while offering benefits of diversification vis-à-vis GIC's other conventional asset classes. The team continuously monitors this portfolio, fine tuning allocations in line with the dynamic global market environment, with the objective of optimizing risk adjusted returns.

Liability management is a vital component of our business strategy and is handled within our treasury operations. In line with our expansion strategy, several funding and liquidity management initiatives were executed during 2005. Significantly, in early 2005, we successfully completed a five year US$200 million syndicated loan program, augmenting our medium term financing. Following this, the second tranche of the US$1 billion EMTN program was launched in mid 2005, further enhancing our funding profile. In both instances the response from regional and international investors was excellent.

Another significant achievement during 2005 was in terms of the corporation's credit rating upgrades. Both the premier global rating agencies upgraded GIC's credit ratings during the year. Moody's upgraded the corporation's long-term deposit and senior unsecured debt ratings to A2 from Baa1, an enhancement of two notches, identifying the strong ownership structure and unique business model as key strengths. GIC's reputation as a high quality credit counterparty was reaffirmed with Standard & Poor's upgrading our long term ratings to A- from BBB+.

Both agencies had a stable outlook for their respective ratings. We believe that the corporation's enhanced rating is indicative of a sound business operation and future business potential.

GIC is committed to playing a key role in the development of the capital markets of the GCC region and has taken steps towards achieving this goal. Over the medium term, we envisage establishing a permanent presence in each of the GCC countries, augmenting our networking capabilities and enhancing our knowledge of the local operating environment.

GIC's strong performance can be primarily attributed to the dedication and commitment of the professional staff and our ability to work together as a single cohesive team. During the year under review, the corporation was successful in attracting highly qualified professionals from the region who brought in a diverse yet complementary set of experiences and skills. We will continue to place emphasis on training fresh GCC graduates with the objective of developing the human resource of the region. During 2005, 16 fresh graduates were recruited, most of whom would be inducted into an intensive training program within the organization, as well as with internationally reputed banking houses. We view our professional staff as a key competitive advantage. I would also like to take this opportunity to thank the Board of Directors for their undiminishing support and guidance.

GIC has always recognized the relationship between returns and risk, and the management of risk forms an integral part of the corporation's strategic objective. The complexity and diversity of risks have increased as a result of a continuous and rapidly changing business environment. As a part of its ongoing efforts to adopt market best practice standards and equip GIC to successfully face future risk management challenges, the risk management team, under the guidance of senior management and the Board of Directors, initiated a comprehensive review of the corporation's risk management framework in 2005.

Internationally reputed external consultants were engaged to conduct a thorough appraisal of the existing systems, with the objective of identifying gaps vis-à-vis global best practices and developing solutions to upgrade to these higher levels where relevant.

Going forward, it is our objective to maintain and enhance the flexibility and adaptability that enabled us to perform well during difficult and changing business environments. I am confident that the strong foundation we have set in place will form an excellent platform for future growth, strength and profitability.

Mr. Hisham Abdulrazzaq Al-Razzuqi
Chief Executive Officer and
General Manager

promoting
private enterprise

Buoyed by high oil prices and elevated investor and business confidence, the GCC economies witnessed another year of strong GDP growth and superior stock market returns. Better macro-economic policies than those prevailing during the last oil boom in the GCC countries have also contributed to a mood of economic optimism among market participants. The world economy was able to handle the large increase in oil prices during the year without problems, and strong economic growth in the US and also in China and India continued apace.

World Economy and Markets

The world economy, according to IMF recent estimates,* is expected to grow this year at the strong rate of 4.3%, after a spectacular performance of 5.1% in 2004. What is significant here is that such strong economic growth was accompanied by substantial increase in the oil prices. Brent oil price average for 2005 was 42.6% higher than the average in 2004 ($38.23). WTI was higher by 36.6% and OPEC Basket by 40.4%. What makes this growth even more remarkable is that the US economy (which represents 29% of the world economy) suffered from two major hurricanes in August and September that destroyed major cities and towns and disrupted economic activities in both Louisiana and Mississippi states in the south of the country.

As Table 1 shows, the US economy is growing by around 3.5% and both China and India are growing robustly at 9.9% and 7.1% respectively. Another major development in the year came in the announcement by Chinese authorities in late November that the economy has been statistically underestimated by a substantial margin (preliminary estimates are in the range of 20%) which means that China's GDP is not around $1.6 trillion, but is closer to the $2 trillion mark. The issue of underestimating the size of the Chinese economy may actually provide at least a partial explanation of the large increase in the demand on oil in 2004 and 2005. Going forward, it adds substance to the prevailing view that oil prices and the balance of supply/demand in the international oil markets is favoring the producers and therefore foreshadows solid oil prices in the years ahead.

Table 1: GDP Growth for Major World Economies (Actual & Forecasts) 2004 – 2005 (% change)

	2004 Actual		2005	
	IMF	Consensus Forecasts	IMF	Consensus Forecasts
US	4.4	4.2	3.5	3.6
Japan	2.6	2.3	2.2	2.4
Euro-Area	2.0	1.8	1.2	1.4
Germany	1.7	1.6	0.8	0.9
France	2.3	2.1	1.5	1.6
UK	3.1	3.2	1.9	1.7
Canada	3.3	2.9	2.9	2.9
China	9.5	9.5	9.0	9.2
India	7.3	6.9	7.1	7.1
World	5.1	3.9	4.3	3.1
Advanced Economies	3.3	-	2.5	-
Other Emerging Markets and Developing Countries	7.3	-	6.4	-
of which:				
Developing Asia	8.2	-	7.8	-
Middle East	5.5	-	5.4	-

Sources:
- International Monetary Fund, World Economic Outlook, September 2005.
- Consensus Economics Inc., Consensus Forecasts, December 2005.
- Consensus Economics Inc., Consensus Forecasts, Global Outlook: 2005-2015.

*IMF, World Economic Outlook, September 2005.

Table 2: Global Equity Indices for 2005 (in local currencies and in US Dollar terms)

Index	31st Dec 04	30th Dec 05	Year end % Change	High 2005	Low 2005	Returns in US$
North America						
DJIA	10,783.01	10,717.50	-0.61%	10,940.55 (4-Mar)	10,012.36 (20-Apr)	-0.61%
S&P 500	1,211.92	1,248.29	3.00%	1,272.74 (14-Dec)	1,137.50 (20-Apr)	3.00%
NASDAQ Composite	2,175.44	2,205.32	1.37%	2,273.37 (2-Dec)	1,904.18 (28-Apr)	1.37%
Russell 2000	651.57	673.22	3.32%	690.57 (2-Dec)	575.02 (28-Apr)	3.32%
DJ Wilshire 5000	41.52	44.17	6.38%	44.97 (14-Dec)	39.15 (20-Apr)	6.38%
Europe						
FTSE 100	4,814.30	5,618.80	16.71%	5,638.30 (29-Dec)	4,783.60 (12-Jan)	4.18%
Xetra Dax	4,256.08*	5,408.26	27.07%	5,458.58 (29-Dec)	4,178.10 (28-Apr)	10.38%
CAC 40	3,821.16	4,715.23	23.40%	4,772.93 (29-Dec)	3,816.14 (12-Jan)	7.19%
Asia						
Nikkei 225	11,488.76*	16,111.43	40.24%	16,344.20 (29-Dec)	10,825.39 (17-May)	22.41%
Hang Seng	14,230.14	14,876.43	4.54%	15,466.06 (15-Aug)	13,355.23 (18-Apr)	4.82%

* Last day of trading was 30th Dec for 2004.
Source: Bloomberg.

The major world equity markets had a good year outside the US. Indeed, 2005 had the superficial anomaly of a strong economic growth in the US coupled with weak equity markets performance and a weaker economic growth (at least compared to the US) in Japan and Europe coupled with strong equity returns. Table 2 shows that in local currency terms, the Japanese equity market was the strongest performer of all major markets (at 40.24%) followed by the German, French and UK markets at 27.07%, 23.40% and 16.71% respectively. The US major equity indices showed positive returns only marginally: 3% for S&P 500, 1.37% for NASDAQ Composite but the Dow Industrial Average was down by less than 1%.

However, for a dollar based investor (such as most of the GCC public and private investors), the returns will look different because the dollar has appreciated against the euro, the yen and the UK pound during the year. Due to this appreciation, returns in US dollar terms in the European and Japanese equity markets are noticeably different but still overall better than the returns in the US equity markets. A dollar based investor in the Japanese market (the Nikkei 225) would gain 22.41% and not 40.24%, similarly, the gain will go down in German (10.38%), French (7.19%), and UK markets (4.18%). It is important to note that the US dollar has appreciated against major currencies despite a continuing deterioration in the current account deficit in the US dollar, estimated at $790 billion in 2005 versus $668 billion in 2004.

The world bond markets were actually not at their best in 2005. From the start of the year, it was obvious that the US Federal Reserve would continue the tightening policies started in June 2004. At the beginning of the year the Federal Fund rate was 2%. The Federal Open Market Committee (FOMC) has raised that rate in every meeting during 2005, starting at February 2nd when rates were raised to 2.25%, and ending on December 13th when rates were raised to 4.25%. When Ben Bernanke, a member of the US Federal Reserve Board started mentioning a “savings glut” as a worldwide phenomenon in a speech in March 2005, the term became current among economists and international financial analysts to explain a phenomenon that Alan Greenspan, the Federal Reserve Chairman coined as the bond markets “conundrum”. What he meant was the fact that while short term interest rates were progressively raised, the long term rates as evidenced in the US 10 year treasuries yield and long term mortgage rates, continued to be stable.

Table 3: World Equity Markets Capitalization Compared with World Economy Share (by Major Markets)

	World Market Capitalization 2005			Gross Domestic Product 2004	
	Current (Mn US$)	Year-end (% Change)	% of World	GDP (Bn US$)	% of World
World	**40,921,068**	**14.15%**	**100.00%**	**40,895**	**100.00%**
US	15,707,695	3.80%	38.39%	11,734	28.69%
Japan	4,949,858	30.06%	12.10%	4,671	11.42%
UK	3,053,394	10.83%	7.46%	2,133	5.22%
France	1,860,920	12.83%	4.55%	2,046	5.00%
Canada	1,274,851	22.51%	3.12%	993	2.43%
Germany	1,285,699	4.75%	3.14%	2,755	6.74%
Hong Kong	1,153,461	40.09%	2.82%	164	0.40%
Italy	812,144	1.75%	1.98%	1,680	4.11%
Switzerland	797,157	12.12%	1.95%	358	0.88%
Australia	705,976	12.09%	1.73%	618	1.51%
Saudi Arabia	657,617	126.44%	1.61%	251	0.61%
Russia	544,621	110.53%	1.33%	582	1.42%
India	546,126	41.61%	1.33%	665	1.63%
Brazil	459,598	44.27%	1.12%	604	1.48%
China	316,911	-27.61%	0.77%	1,654	4.04%
Rest of the World	6,795,040	-	16.60%	9,986	24.42%

Source: Bloomberg.

While short term rates (as in Fed Funds Rate) moved from 2% at the beginning of 2005 to 4.25% at year end, the yields on 10-year US Treasury bond moved from 4.22% in December 31st 2004 to 4.39% on December 30th 2005. Bernanke's "savings glut" concept is now commonly used to explain, at least partially, this "conundrum" in bond yields. Generally, investors in the major bond markets have suffered; Merrill Lynch Global Corporate Bond Market Index returned 3.19% in 2005 compared with 5.76% in 2004 and Merrill's Global High Yield Index returned 3.15% in 2005 compared to 11.42% in 2004. Investors in emerging markets bonds, however, were better off with JP Morgan EMBI+ Index returning 11.89% for the year.

Commodity investors, had a better year in 2005 compared with 2004. The Bloomberg Dollar Commodity Index returned 18.1% in 2005 compared to 6.6% in 2004. Commodity prices, and not only oil, have shown strong gains in 2005.

Oil Market Developments

The world oil market, which witnessed an increase in demand of more than 3% in 2004, continued on its path of increased demand in 2005 estimated to range between 1.2% and 1.5% as shown in Table 4. The story of oil in 2005 was actually not the problem in oil supplies meeting demand. It was rather a prevailing jittery mood that most oil countries were producing at full capacity and that spare production capacity was dwindling compared to spare capacity in 2004 which was above 3 million barrels/day as Table 5 shows. That led non-commercial players in the oil market to take positions on oil prices that have contributed to an upward push on prices.

In addition, most of the extra crude production coming from OPEC producers (particularly those in the GCC) was in heavy crudes which are not easily refined, which meant that the products markets were extremely tight. For example in the US no new refining capacity was added during the past 25 years and refining upgrades (which enable refiners to handle heavier crudes) were not coming on stream speedily enough to allow product markets to respond to the increase in supply of heavy crudes.

Table 4: Global Oil Demand and Supply (mn b/d)

CGES	2004 mn b/d	2004 % Change	2005e mn b/d	2005e % Change
(a) World Oil Demand	82.2	3.8%	83.4	1.5%
(b) Non-OPEC Supply[1]	49.9	-4.8%	49.9	0.0%
Difference (a-b)	32.3		33.5	
OPEC Crude Production[2]	29.0	7.0%	30.0	3.4%
Balance	-3.3		-3.5	

e: Estimates.
1: Including OPEC NCLs and non-conventional oils.
2: Selected secondary sources.
Source: Centre for Global Energy Studies, Monthly Oil Report, 19th Dec. 2005.

OPEC	2004 mn b/d	2004 % Change	2005e mn b/d	2005e % Change
(a) World Oil Demand	82.1	3.7%	83.2	1.3%
(b) Non-OPEC Supply	49.9	2.3%	50.1	0.6%
Difference (a-b)	32.2		33.1	
OPEC Crude Production	29.1	7.8%	29.9	2.7%
Balance	-3.1		-3.2	

e: Estimates.
Source: OPEC, Monthly Oil Market Report, January 2006.

IEA	2004 mn b/d	2004 % Change	2005e mn b/d	2005e % Change
(a) World Oil Demand	82.2	2.9%	83.3	1.3%
(b) Non-OPEC Supply	50.1	1.1%	50.1	0.0%
Difference (a-b)	32.1		33.2	
OPEC Crude Production	28.6	1.8%	29.2	2.1%
Balance	-3.5		-4.0	

e: Estimates.
Source: IEA, Monthly Oil Report, January 2006.

EIA	2004 mn b/d	2004 % Change	2005e mn b/d	2005e % Change
(a) World Oil Demand	82.5	2.7%	83.7	1.5%
(b) Non-OPEC Supply	50.1	1.2%	50.1	0.0%
Difference (a-b)	32.4		33.6	
OPEC Crude Production	29.1	2.0%	30.1	3.4%
Balance	-3.5		-3.5	

Source: Energy Information Administration, Short-Term Energy Outlook, December 2005.

Table 5: OPEC Oil Production and Spare Capacity (mn b/d)

	Avg. Production			Avg. Capacity		Spare Capacity	
	2003	2004	2005**	2004	2005	2004	2005**
Algeria	1.11	1.21	1.36	1.33	1.36	0.12	0.00
Indonesia	1.03	0.97	0.94	0.98	0.95	0.01	0.00
Iran	3.73	3.95	3.90	4.06	4.02	0.11	0.12
Iraq	1.33	2.03	1.86	2.10	2.04	0.07	0.18
Kuwait*	2.20	2.31	2.46	2.40	2.49	0.09	0.03
Libya	1.41	1.52	1.66	1.60	1.66	0.08	0.00
Nigeria	2.16	2.35	2.37	2.60	2.53	0.25	0.16
Qatar	0.76	0.78	0.78	0.95	0.82	0.17	0.04
Saudi Arabia*	8.84	9.12	9.45	11.00	10.65	1.89	1.20
UAE	2.22	2.35	2.43	2.55	2.53	0.20	0.10
Venezuela	2.33	2.55	2.62	2.63	2.63	0.08	0.01
Total OPEC	**27.10**	**29.13**	**29.84**	**32.20**	**31.64**	**3.07**	**1.80**

* Includes 50% share of neutral zone.
** till November 2005.
Source: MEES and CGES various issues.

Table 6: Spot Crude Prices, Monthly and Yearly Average (US$/bl)

	OPEC Basket	Brent	WTI
January 05	40.24	44.01	46.64
February 05	41.68	44.87	47.69
March 05	49.07	52.60	54.09
April 05	49.63	51.87	53.09
May 05	46.96	48.90	50.25
June 05	52.04	54.73	56.60
July 05	53.13	57.47	58.66
August 05	57.82	64.06	64.96
September 05	57.88	62.75	65.28
October 05	54.63	58.75	62.67
November 05	51.29	55.41	58.42
December 05	52.64	56.75	59.42
Year Average			
Year 2005	50.64	54.44	56.19
Year 2004	36.05	38.23	41.44
Year 2003	28.10	28.81	31.09
Year 2002	24.36	25.03	26.13
Year 2001	23.12	24.46	26.00

Note: OPEC price averages are usually lower than Brent.
Source: MEES, 12 December 2005 and Bloomberg.

All this was reflected in an upward trend in prices as shown in Table 6. It is also important to note that the structural changes in oil market fundamentals which began to be felt in 2004, have led to a rethinking of oil price expectations. WTI prices hit the $70 mark in September as result of hurricane Katrina destruction of US Gulf storage and refining capacity. Prices came down later to below the $60 mark but there is a belief among oil analysts of various backgrounds (i.e., energy organizations such as IEA and EIA and investment banks such as Goldman Sachs, Merrill Lynch and JP Morgan) that high oil prices of around $50 and above are going to continue during 2006 and beyond as shown in Table 7.

The implications of this secular change in the oil markets is of fundamental importance to the world economy but particularly to the GCC economies.

supporting
economic growth

Table 7: Crude Oil Price Outlook (Year Average) US$/bl

Source		Period	
WTI			
	2006	**2007**	
EIA	64.98	60.63	
	2006	**AVG. (2007 - 09)**	
Goldman Sachs	65.00	60.00	
	2006	**2007**	**2008**
CGES	64.64	62.48	61.03
	Year End 2005	**End Sep. 2006**	
Consensus Economics	62.70	57.20	
	2006	**2007**	
UBS	64.00	66.00	
	2006	**2007**	
JPMorgan	56.25	50.00	
	AVG. (2005 - 10)		
BCA	50.00		
Brent			
	2006	**2007**	
EIU	56.00	46.75	
IIF	55.00		

Table 8: GCC Aggregate of Trade and Current Account Balance (US$ bn)

	2003	2004	2005*
Trade Balance	107.6	152.4	245.8
Current Account	51.7	92.8	180.7

* Estimates.
Source: IIF, GCC Report, July 29, 2005.

Table 9: Oil Export Revenues (Nominal US$ Bn)

	Estimate 2004	Forecast 2005	2006
Bahrain	5.8	7.8	7.9
Kuwait	27.8	40.9	43.3
Oman	10.9	15.2	16.6
Qatar	15.4	23.0	23.8
Saudi Arabia	110.8	167.0	173.5
United Arab Emirates	38.4	57.2	60.8
GCC	**209.1**	**311.1**	**325.9**

Source: The Institute of International Finance, Country Reports, 29th July 2005.

Table 10: GCC Real GDP Growth 2004 and 2005 (% change)

	2004				2005*		
	Nominal GDP US$ bn	IMF	IIF	EIU	IMF	IIF	EIU
Bahrain	11.0	5.4	5.4	5.3	7.1	9.2	5.9
Kuwait	55.7	7.2	6.3	7.2	3.2	5.6	4.5
Oman	24.8	4.5	3.8	0.7	3.8	4.6	1.9
Qatar	28.5	9.3	11.4	9.9	5.5	12.0	8.8
Saudi Arabia	250.9	5.2	5.2	5.3	6.0	6.0	6.5
United Arab Emirates	103.1	8.5	7.4	7.4	5.6	7.3	6.7

* Estimates.
Sources:
• International Monetary Fund, World Economic Outlook, September 2005.
• IIF, Country Reports, July 2005.
• EIU, Country Forecast September 2005.

GCC Economies: Oil-Driven Growth and Continued Restructuring

The change in the economic fortunes of the GCC region started in the middle of 2003. At that time, external threats represented by the previous Iraqi regime disappeared, the world economy was on an expansion trajectory particularly in the US but also in China, and with an invigorated economic engine, the demand on oil started an upward trend that was particularly evident in 2004. The GCC governments and especially the Kingdom of Saudi Arabia were the main beneficiaries of this trend. Government budgets started to be in surplus as a result of strong oil prices and the external position of the GCC countries became positively on the plus as shown in Table 8. The increase in oil prices, however, peaked during 2005 and Table 9 shows that oil revenues of the six countries which reached $209 billion in 2004 were expected to exceed $300 billion in 2005.

The large increases in oil revenues since 2004 have enabled the GCC economies to handle bottlenecks and imbalances facing them.

In Saudi Arabia, the government made it a priority to pay outstanding domestic public debt and to meet pressures for social spending, increasing civil servant salaries and hiking the spending on social programs such as education and health. In surplus countries such as the UAE and Kuwait, elevated government revenues were directed to build financial reserves but also to public spending, mostly on new projects. In Qatar, because of the small size of the population and the ambitious plans to expand natural gas production and exports, the government was in a comfortable position to continue its programs for natural gas expansions and also to start ambitious property development projects that should result in increasing the absorptive capacity of the economy.

The high levels of liquidity during the year have spawned the boom in the stock markets but also the high levels of inflation particularly in Qatar and the UAE.

We will discuss the GCC stock markets in detail but it is particularly significant that the change in the GCC economic fortunes has been highlighted by the fact that 2005 was the year in which the Saudi stock market became the most valuable emerging stock market by capitalization (see Table 3). This major development was fueled by two important factors: the increase in the number of shares listed and a spectacular increase in prices as shown in Table 11.

The increase in oil revenues meant also that GDP growth was exceptionally good compared with the average for the last ten years. Table 10 shows growth in the six GCC economies for the year 2004-2005. According to IIF estimates Qatar's real GDP growth in 2005 would reach 12%. That is not at all surprising and the nominal growth may actually be closer to 20%-25%. Saudi Arabia which averaged 1.45% for the period 1993-2002, should grow by close to 6% in real terms in 2005. The increase in oil income has meant that 2005 would surpass 2004 in growth terms.

Table 11: GCC Stock Markets Performance (2001–2005)

Total Return Index

GIC Indices	Y/Y % change 2001	2002	2003	2004	**2005**	31st Dec 2004	31st Dec 2005	Trailing P/E	Dividend Yield(%)
Composite	24.1	17.7	57.4	69.2	**116.8**	4,201.25	9,105.82	41.07	1.38
Bahrain	0.0	8.1	44.3	46.8	**25.8**	1,846.11	2,322.67	19.60	3.68
Emirates	36.4	20.7	32.2	114.1	**140.9**	3,907.62	9,414.59	48.41	1.67
Kuwait	44.8	26.9	62.4	13.5	**84.5**	3,874.04	7,150.60	21.28	2.05
Oman	-37.4	54.7	62.9	36.3	**48.2**	1,937.53	2,871.82	15.88	3.58
Qatar	57.0	38.5	76.5	49.0	**101.7**	5,800.67	11,697.87	41.00	1.52
Saudi Arabia	14.2	7.0	59.9	94.8	**124.3**	4,298.88	9,641.85	45.01	0.99

Source: GIC Equity Research.

The full picture for the GCC economies in 2005 will not be complete without mentioning the continuing process of restructuring, privatization and business expansion that has been taking place in all the economies of the region. Some of the highlights are mentioned below.

In Bahrain, the Aluminum Company (ALBA) is expanding capacity to reach 830,000 tonnes at a cost of US$1.7 billion; that expansion will place ALBA among the largest producers in the world. Bahrain also established a Ministry of Planning during the year and spent $80 million establishing 20 centers to help job seekers find employment. It announced major property development projects: The Bahrain Bay, a US$1.5 billion development of commercial, residential space on the north-east coast of Manama; the Riffa Resorts project costing US$300 million and the Bahrain Financial Harbor at US$1.3 billion. It is significant to mention that during 2005 agreements were signed to start the construction of a $230 million stainless steel project developed by the Gulf Investment Corporation (GIC) in Bahrain. The project brings together private and public sector investors from Kuwait, Saudi Arabia and Qatar in addition to GIC.

In Kuwait, it was announced that private sector developers will construct and manage the port Boubyan Island by developing it into a commercial seaport with an estimated cost of US$3.5 billion. Kuwait Oil Company is boosting its oil production with the construction of its fourth facility in Shuaiba. The estimated capacity will reach 615 thousand b/d making it the biggest in the Middle East.

The government has amended its Banking Law and during 2005 three licenses were granted to foreign banks to open branches in Kuwait: HSBC, BNP Paribas and Citicorp.

In Oman, the demand for gas is growing rapidly which encouraged the expansion of Oman LNG plant at Qalhat. This will increase the capacity to 11 million tones per year by 2006. A UK company, Petrofac, signed a contract with Petroleum Development Oman (PDO) to construct the Kauther gas plant. The 20mn cu.ms/day plant is scheduled for completion in late 2007.

New announced projects include: the Oman-India Fertiliser Company in Sur with total cost of US$969 million, Sohar Oil Refinery which will produce propylene and other products costing US$1.3 billion and petrochemical projects in Sohar and Salalah with total cost estimated at around US$3.5 billion. In the tourism sector, the construction of Salalah Free Trade Zone which started in March 2005 is expected to be completed by early 2006.

In Qatar, the main focus was on its hydrocarbon resources as it is projected to be the world's largest exporter of LNG by 2007. LNG production capacity is expected to grow from around 20 million tons in 2004 to 25 million by the end of 2005 and 77 million by 2012. Developing the energy sector involves massive capital spending of around US$40 billion. Qatar's booming real estate market may create some challenges in terms of severe shortages in building materials.

Qatar also announced a US$5.5 billion new international airport which is set to open by 2009. Another major real estate project is 'The Gate', a giant mixed-use development project located in Doha's new business district and scheduled to be completed within three years at a cost of US$151 million. Another mega project is the $1 billion Waad City. During December Qatar Petroleum (QP) and Maersk agreed on a new $5 billion plan for further development of the offshore Al Shaheen field; the project will lift oil production by 282,00 0b/d when completed in late 2009.

In March 2005, Japan's JGC was awarded a contract for Hawiyah in **the Kingdom of Saudi Arabia** that involves building the world's largest NGL processing plant. Hawiyah is located south of Dhahran and east of Riyadh near the giant Ghawar oil field and represents the largest Saudi natural gas project in more than 10 years, and the first to process only non-associated gas from the deep Khuff and Jauf reservoirs.

In March, the government of Saudi Arabia took the first step towards privatization of the Saline Water Conversion Corporation (SWCC), the Kingdom's leading water desalination organization, by appointing its new Board of Directors that includes representatives of the private sectors. Also, by year end, the Ministry of Finance had licensed ten regional and international banks to operate in the Kingdom.

In July 2005, a new $3.6 billion refinery and petrochemical plant complex was inaugurated in Fujian, China. The facility is a joint venture between Sinopec (50%), ExxonMobil (25%), and Saudi Aramco (25%).

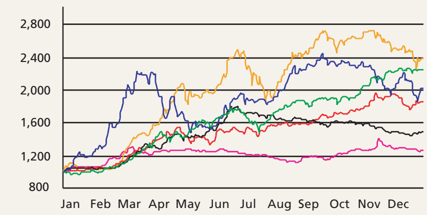
Saudi Arabia's first Independent Water and Power Project (IWPP), Shu'aiba Water and Electricity Company (SWEC), was established during August. Its sponsors include the Public Investment Fund and a Malaysian-led consortium comprising Acwa Power and Tenagh Nacional Berhad, with the support of international and Saudi financing. The government intends to offer shares to the public at a later stage.

In December 2005, Saudi Arabia became a member of WTO, a result of efforts that started in July 1993. Also, during the year, the Kingdom completed the formation of 178 municipal councils throughout the country in line with directives issued by the Custodian of the Two Holy Mosques. Half of the members of the municipal councils were elected last spring. It is also worth noting that Saudi Arabia's cabinet recently approved the merger of General Petroleum and Mineral Organization with Saudi Aramco and in December, it announced a US$27 billion project to develop King Abdullah Economic City in Jeddah.

In the UAE, Dubai recently launched projects which include Dubai Internet City, Dubai Healthcare City, Dubai Knowledge Village, Dubai Metro and Dubai snow resort at Mall of the Emirates. These new construction projects place the country in a leading position on a regional basis.

In Abu Dhabi, Sheikh Khalifa bin Zayed Al-Nahyan, UAE President, announced the first election of the Federal National Council members. It will consist of 40 members of which 20 will be elected and the remaining will be appointed by the rulers of the seven emirates. This constitutes an important step in the process of reform and restructuring that is taking place in the GCC region. The UAE President also issued a decree in August, allowing non-GCC citizens to own property in the UAE.

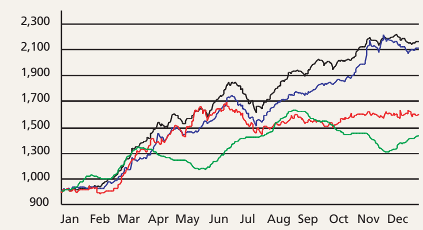
Figure: 1 Composite & Sector Performance Relative to Crude Oil



Bahrain
Emirates
Kuwait
Oman
Qatar
Saudi Arabia

Source: GIC Equity Research Department.

Individual Country Indices Performance (Normalized)



Composite
Banking
Telecom
Spot Brent Crude

Source: GIC Equity Research Department.

GCC Equity Markets

Performance Highlights

GCC stock markets were markedly higher across the board during 2005. The GIC Composite Index closed the year at 9105.82, up a remarkable 116.8% for the year. Following a performance of 69.2% in 2004, the rise in 2005 further underscores the strength of the market in GCC stocks that has been in force for the past few years.

Saudi Arabia contributed the most to this performance, with 69.7 percentage points of the total rise in the GIC Composite Index coming from the Saudi equity market, Emirates (UAE) coming in second at 19.9 percentage points. Kuwait equity market contribution ranked third among the GCC Equity Markets, overshadowing the Qatari stock market that been always ranked third in country contribution for the last two years.

Table 12: Return Contribution Analysis

GIC Composite Index	
Closing Value	9,105.82
Value Traded ($ mln)	1,085,826
Value Traded Previous Year ($ mln)	408,764
Change During Year	116.8%
Change During Previous Year	69.2%
Market Cap ($ mln)	497,116

Country Contribution to Change in GIC Index (2005)	
Bahrain	0.7%
Emirates	19.9%
Kuwait	18.6%
Oman	0.7%
Qatar	7.0%
Saudi Arabia	69.7%

Sector Contribution to Change in GIC Index (2005)	
Banking	49.1%
Telecom	11.3%
Other	56.4%

Source: GIC Equity Research Department.

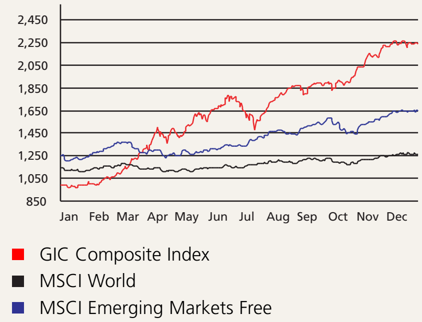
With world markets only managing a late-year rally, regional markets outperformed dramatically. Compared to the GIC Composite Index (at 116.8%), the 2005 gains of Morgan Stanley Capital International's (MSCI) World Index and Emerging Markets Index were markedly less spectacular at 10.2% and 31.0%, respectively.

Volumes also exploded once again, as trading activity continued to pick up in all six countries with no exception. Value traded during the year was more than 2.6 times the levels seen in the previous year, coming in at $1,085.8 billion, following a 2.7 fold increase in 2004 over 2003.

The surge in trading activity was most dramatic in Saudi Arabia which accounted for 82% of all trading liquidity in the region versus 90% the previous year and 81% the year before. Emirates occupied second place, albeit with a diminished share of only 10% of overall liquidity versus 1.4% in 2004 and 1% in 2003.

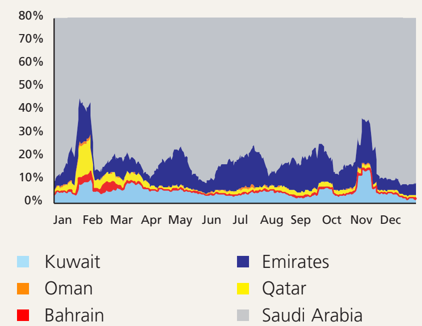
The year opened with the 130 constituents in the GIC Composite Index representing a private-sector market capitalization of $186.2 billion. Four quarterly index reviews later, involving a number of additions and deletions that took into consideration the increased prominence of small cap stocks, especially in Saudi Arabia, the number of companies in the Composite was 156 at the end of the year.

Figure: 2 Relative Performance vs. World Markets



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

Figure: 3 Contributions to Value Traded



Source: GIC Equity Research Department.

Table 13: Risk/Return Analysis for 2005

	Annualized Return	Annualized Standard Deviation of Daily Returns (12 Months of Data)	Sharp Ratio
Composite	116.8%	15.6%	7.3
Bahrain	25.8%	14.5%	1.6
Emirates	140.9%	33.9%	4.1
Kuwait	84.5%	18.7%	4.3
Oman	48.2%	17.7%	2.5
Qatar	101.7%	35.2%	2.8
Saudi Arabia	124.3%	23.5%	5.1
Banking	111.5%	15.5%	7.0
Telecom	59.5%	20.4%	2.8
MSCI World	10.2%	8.1%	0.9
MSCI EMF	31.0%	12.2%	2.3

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

Driven mainly by the strong performance of most constituents, market capitalization of the index at the end of the year rose to $497.1 billion.

Bahrain, Kuwait and Oman saw their volatility rise in 2005 compared to the preceding year, as measured by the annualized standard deviation of daily returns. Volatility in Qatar, Saudi Arabia and the UAE rose markedly during the year with the latter more than tripling from the level seen between 2001 and 2004. This is a somewhat expected side effect of strong performance.

Despite higher volatility, returns outstripped the increased risk by a good margin in all markets except Bahrain. This is clearly shown by looking at Sharp Ratios.

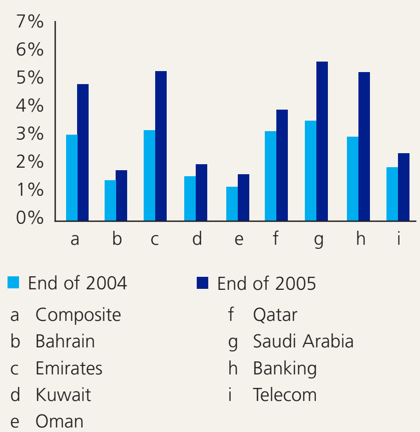
While part of the rise in stock prices during 2005 was surely linked to higher levels of reported profits and dividend distributions, a sizeable portion of the appreciation resulted in expansions of earnings multiples (PEs) and reductions in yield; clear signs of higher future growth expectations and lower perceptions of risk that usually accompany speculative behavior.

Correlation with World Markets

Unlike the trend prevailing historically, where the region's markets were highly negatively correlated with the rest of the world, 2005 saw a continuation of the convergence of markets seen during 2004, albeit at a lower level. Correlation between the MSCI World Index and the GIC Composite Index went from +0.43 in the period 2001-2004 to +0.78 during 2005. Similarly, correlation between the MSCI EMF Index and the GIC Composite moved from +0.90 during 2001-2004 to +0.84 in 2005.

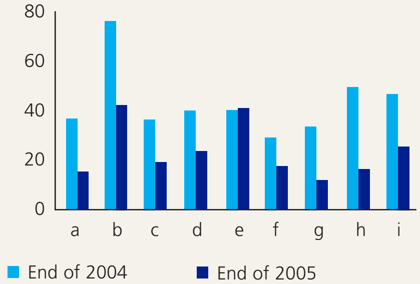
Figure 6 shows that correlation between spot prices for Brent crude oil and the GIC Composite Index rose to +0.77 during 2005 compared with +0.73 in the four preceding years. Correlation between Brent and the MSCI World Index went from +0.68 in the period 2001-2004 to +0.61 in 2005.

Figure: 4
Trailing PE Changes During 2005



Source: GIC Equity Research Department, regional exchanges.

Figure: 5
Dividend Yield Changes During 2005



Source: GIC Equity Research Department, regional exchanges.

Decline in Weight of Banking & Telecom Stocks

As companies from a wider variety of sectors are opening up to private sector investments across the region, and are therefore listed on regional exchanges, the traditional make-up of markets continued to change in 2005. The preceding year had witnessed the beginning of a trend, whereby every quarterly review of the GIC Indices brought with it a precipitous decline in the weight of banking stocks. Ending 2003 at a weight of 47.9% of the GIC Composite Index, the banking sector represented 40.1% of that index by the end of 2004 and declined further to 35.6% in 2005.

The telecom sector did experience two listings during the year, which is Oman Telecommunication Company and Etihad Etisalat Company. Nevertheless, the telecom sector did see its share of the region's total market cap shrink to 13.4% in 2005 from 17.5% in 2004. Picking up the extra weight were the industrial, finance and real estate sectors.

Shifting in Country Weights

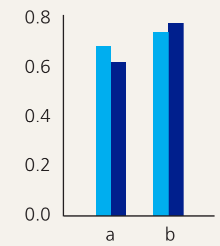
The inclusion of a number of new Saudi companies continued to push that country's share in the GIC Composite Index higher. With the impressive performance of the UAE in 2005, its share rose during the year, mainly at the expense of Kuwait's share, which lagged behind other regional markets.

Good performance of Qatari stocks continued to help increase that country's weight in the GIC Composite Index during 2005, while a general lag in both performance and new listings in Bahrain continued to see that market decline in weight.

Conclusions

In concluding the Economic Review, the year brought in another boon to the region in terms of growth, business expansion and economic optimism. As common in similar situations, investors tend to underestimate risk and to be over confident, as reflected in GCC asset prices which ballooned during the year. Because the economic fundamentals of the region look solid, this strong economic picture may continue with us for some years. A word of caution, however, is in order: investors should be ready for increased volatility and some corrections in asset prices along the way.

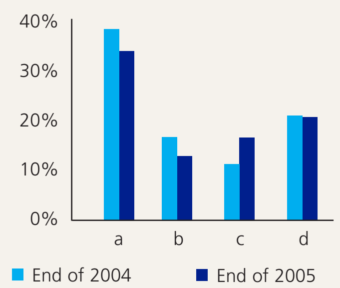
Figure: 6
Changes in Correlations with Crude Oil



a Spot Brent Crude vs. MSCI World
b Spot Brent Crude vs. GIC Composite

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

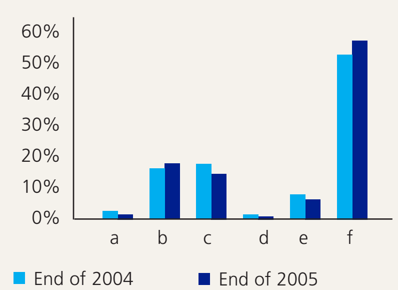
Figure: 7
Changes in Sector Weights



a Banking
b Telecom
c Finance & Real Estate
d Industrial

Source: GIC Equity Research Department.

Figure: 8
Changes in Country Weights



a Bahrain
b Emirates
c Kuwait
d Oman
e Qatar
f Saudi Arabia

Source: GIC Equity Research Department.

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

Gulf Investment Corporation's net income in 2005 reached historical record levels. At US$272.8 million, net income for the year was US$137.4 million or 101.5% up on the prior year. This represents a return on adjusted average equity of 22.5% compared to 12.3% in 2004, and a return on paid up capital of 36.4% compared to 18.1% in the previous year.

Year 2005 was a challenging year for the spread-based investment, due to the increasing interest rate environment. However, the dynamics of GIC's asset mix, the strength of its core investments and the diversified blend of its investment activities provided GIC with resilience to achieve higher level of profitability.

Net interest income was down by 66.3% compared to the previous year, but the fact that investment and other income reported an increase of 163.3% compared to 2004 confirms the strength of GIC's investment philosophy.

Net Interest and Similar Income

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

Spread income from the debt securities portfolio continued to be the major significant contributor to interest income.

Gross interest and similar income grew 17.0% to US$191.8 million during 2005. The 66.5% increase in interest expense due to the increase in interest rates, resulted in a net interest income of US$20.6 million.

Net interest income is reported net of funding the cost of non-interest bearing investments from which income is derived in the form of dividends, capital gains and share of profits, which are reported in the relevant category in investment and other income.

The negative impact of the upward movement of interest rates has been mitigated through the hedge against the risk of increase in interest rates. A major portion of the long duration fixed rate debt securities was hedged against this risk. This also enabled us to lock-in future earnings at the most opportune time. Margin income on available-for-sale securities nevertheless decreased in 2005 with maturing assets being replaced at lower spreads.

GIC's money market activity continued to generate strong interest earnings in 2005, which shows commendable growth of 90.2% on the prior year.

The outstanding balance of "due from shareholders", arising from the sale of GIB in 2001, earned a competitive return of approximately 3.3% during 2005. Income from this receivable decreased to US$2.5 million from US$8.0 million in 2004 due to the reduction in the outstanding balance. (Details of this transaction are 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. As a result, income from these credit funds, constituting over 94.2% of aggregate income from the loans and the credit funds category, registered a year-on-year increase of 61.1%. 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 22.2 to the Financial Statements. Exposure to interest rate risk is restricted due to the limited mismatch between the repricing of a majority of the Corporation's assets and liabilities.

Investment and Other Income

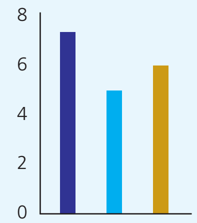
Investment and other income for the year at US$309.1 million posted a record increase of 163.3% over the year 2004 comparative income. Adherence to appropriate entry and exit strategies in GCC equities, strong performance growth of projects and proper allocation of investments contributed to outstanding results for the year. A detailed breakdown of Investment and other income is available in Note 18 to the Financial Statements. The key constituents of investment and other income are discussed below.

The net gain on trading securities and managed funds in 2005 rose to US$60.6 million, an increase of 76.7% on the prior year.

At US$33.2 million, earnings from hedge fund and managed future investments, formed the major component of this category. 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. Gains from GCC's equity portfolio amounted to US$22.3 million for the year, buoyed by strong performance of the regional markets. The balance of income in this category represents gains from the trading bonds, managed funds and money market funds portfolios.

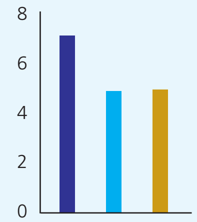
The Investment securities portfolio posted a robust gain of US$47.2 million, an increase of 195.0% on the prior year. 71.1% of the net gain was realized from the sales in GCC's Internal Equity portfolio. Qatari and Saudi equities accounted for most of the realized gains. Other equity and convertible funds contributed 11.1% and the remaining 17.8% of the net gain was from debt securities portfolios.

Operating Income as a Multiple of Operating Expenses



2005	**7.2**
2004	4.9
2003	5.9

Net Revenue as a Multiple of Operating Expenses



2005	**7.0**
2004	4.8
2003	4.9

Net gain of US$45.0 million was realized from the sale of a few projects (US$3.6 million) and partial liquidation of quoted investments in three projects held as available for sale (US$41.4 million).

Income from investments in international equity funds increased to US$26.7 million in 2005 from US$15.8 million in the previous year. Management believe that the gradual recovery witnessed by the global private equity sector during 2005 is likely to continue in the future.

Projects and equity participations posted remarkable earnings of US$89.1million, an increase of 240.1% on the prior year. This represents mainly GIC's share of profits from unconsolidated subsidiaries and associated companies. Additionally, dividend income of US$12.3 million was earned in 2005 and is included within the “Dividend income” category. The excellent performance during the year can be primarily attributed to enhanced operating margins for several companies within GIC's portfolio of project investment. With representation on the Board of Directors of most of the ventures, 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 commercial rate of return. Several of the project participations are green field in nature and still in start-up mode. Earnings from such participations are expected to grow with the maturing of these projects.

Dividend income of US$21.6 million, an increase of 107.7% on the prior year comprises receipts from equity funds, equity portfolios, managed funds and project investments.

Fees, commissions and sundry income earned totaled US$18.5 million, an increase of 31.2% on the prior year. Fee income was generated by the financial advisory, underwriting service, management of funds and development of projects. The marketing 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 utilisation.

Operating Expenses

Management of expenses remains a priority for the corporation. We continue to maintain a sharp focus and discipline in our cost structure by managing recurring costs while improving efficiency through investment in technology, systems and training.

Productivity, expressed in terms of total operating income as a multiple of related operating expenses at 7.2 shows significant increase on the prior years. Net revenue, after reducing loss provisions for the year as a multiple of operating expenses was 7.0 in 2005 compared to 4.8 in 2004.

Operating expenses are made up of employee compensation and benefits, occupancy, information technology, and other expenses. Staff costs, the major compensation, which varies in accordance with individuals as well as Corporate performance. Information technology costs include expenditure relating to ongoing enhancement of computer systems.

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.

As a result of our conservative provisioning policy, the net charge for the year in provisions was US$11.4 million in 2005, more by US$6.3 million charged in 2004. Provisions for the current year included US$7.7 million relating to projects and equity participations, US$5.0 million for decline in the value of equity funds and a general provision of 2% amounting to US$1.8 million on placements with non-bank financial institutions in accordance with Central Bank of Kuwait instructions. US$1.0 million of provisions made against certain debt securities during previous years were reversed in 2005 due to an improvement in market value. Also, US$1.1 million relating to loans and guarantees and US$1.0 million pertaining to accounts receivable were reversed in 2005. A detailed breakdown is provided in Note 19 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 criteria in asset allocation decisions, total assets during the year reached US$7,445.0 million, up 2.6% over the previous year end. 2005 witnessed a more balanced expansion in assets within the principal investing activity, trading securities and managed funds and equity fund portfolios registering double-digit growth. Investment securities registered a decrease. Diversification in sources of revenue was further enhanced during 2005 with investments being made in products with superior risk-return characteristics. The outstanding receivable balance “due from shareholders” was further reduced by US$141.9 million during 2005.

The corporation's strategic focus continues to be on the GCC states and their major trading partners in the industrialized world. Note 22.6 to the Financial Statements sets out the geographic distribution of the Corporation's assets.

The following sections provide details on the key asset categories.

Investment Securities

As at 31 December 2005, the investment securities portfolio made up 54.6% of GIC’s total balance sheet assets. The portfolio witnessed a net decrease of 12.4% during the year. This was largely contributed by maturities within the debt securities portfolio which was partially offset by significant increase in non-debt related assets within the portfolio. This portfolio was established to provide stable coupon / spread income and as a reserve of additional liquidity. With almost 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-a-vis GIC’s other GCC based investments. The investment securities portfolio is composed mostly of investment grade marketable debt securities. Investments in equities and funds, at US$414.8 million, form less than 10.2% of this portfolio.

Investment securities totaled US$4,062.0 million at 31 December 2005 as against US$4,636.1 million at end of 2004. The investment securities portfolio includes securities available for sale of US$3,815.6 million and securities held to maturity of US$246.4 million. Approximately 95% 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$117.4 million in unrealized gains relating to investment securities available for sale were included within shareholders' equity as at year end 2005. Within the held to maturity portion, the fair value of holdings exceeds book value by approximately US$3.2 million.

These significant increases in market value are indicative of the superior quality holdings within the portfolio. Within the held to maturity portion, US$1.0 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 38, and other details, including rating profile, are contained in Note 5 to the Financial Statements. About 55% of the investments within the portfolio comprise of investments within the banking and financial sector and about 16% in the government sector.

Loans and Credit Funds

This category includes loans and advances of US$29.7 million and investments in credit funds of US$450.0 million. Outstanding loans declined by 28.4% year-on-year, in line with the strategic decision to discontinue this business and allow loans to run-off. A further 45.1% of currently outstanding loans are due to mature by the end of 2006. Credit funds, yielding higher spreads than GIC's loan portfolio, are managed by experienced external international fund managers and offer enhanced risk adjusted returns.

As of 31 December 2005, loans and advances were entirely to customers within the GCC countries. There were no significant concentrations by industrial sector at the year end. Investments in credit funds were distributed among several managers within North America and Europe.

Based on contractual maturities at the balance sheet date, approximately 46% of the outstanding loans and investments in credit funds were due to mature within five years, with 5% due to mature within one year. Details of the maturity profile are given in Note 22.1 to the Financial Statements, and other details including loss provision made are contained in Note 6.

maximizing

shareholder value

Total loan loss provisions including loan guarantees amounted to US$4.1 million at 31 December 2005. Counterparty specific provisions amounted to US$2.3 million while general provisions were US$1.7 million. The US$2.3 million 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.

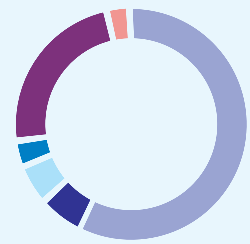
As of 31 December 2005, there were no non-performing loans within GIC's loan book.

Trading Securities and Management Funds

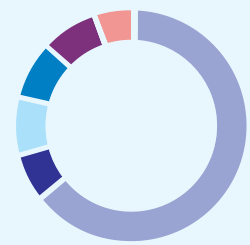
Trading securities and managed funds grew 89.4% during 2005 to reach US$1,129.1 million. The bulk of the portfolio comprises of investments in a range of alternative asset strategies, managed by a diverse pool of external managers. The portfolio of alternative asset investments is continuously monitored and restructured to fit GIC's risk-return profile, while gradually expanded in line with growth targets. Fresh investments of US$506.1 million were made during the year, bringing the overall exposure to alternative strategies and other funds to approximately US$974.3 million at 31 December 2005. The Alternative strategies fund (ASF), managed by GIC in association with internationally reputed managers, had another successful year.

The proprietary trading portfolios within this category are managed by the corporation's asset management team and cover the GCC bond and equity markets. This portfolio of US$149.6 million is made up of investments in two bond funds of US$107.9 million and an exposure to GCC equity markets of approximately US$41.7 million. GIC continues to remain committed to the gradual expansion of the GCC debt and equity portfolios, taking advantage of its unique knowledge of the region. Details of the Corporation's trading portfolio are given in Note 4 to the Financial Statements. Trading securities and managed funds are accounted for at market value.

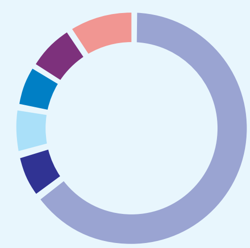
Asset Mix by Category



2005



2004



2003

	2005	2004	2003
Investment Securities	**54.6%**	63.9%	64.6%
Loans and Credit Funds	**6.4%**	6.8%	6.7%
Trading Securities and Managed Funds	**15.2%**	8.2%	6.2%
Investment in Projects, Equity Participations and Equity Funds	**12.4%**	8.3%	6.3%
Placements & Other Interest bearing assets	**8.3%**	7.9%	7.0%
Other Asset Categories	**3.1%**	4.9%	9.2%

Placement and Other Interest Bearing Assets

Placements amounted to US$582.4 million at 2005 year end. Reciprocity is a key feature of our placement policy. Note 22 to the Financial Statements provides the maturity profile of placements. All placements mature within one year. Of this, US$474.8 million had a maturity within three months. Only 14.7% of total placements were with non-bank financial institutions. Other liquid assets at the balance sheet date included US$7.5 million cash and bank balances.

Placements during the year are shown net of provisions amounting to US1.8 million, being 2% general provision in accordance with Central Bank of Kuwait instructions on placements with non-bank financial institutions which stood at US$87.6 million at year end 2005.

Equity Funds

Equity funds amounted to US$184.2 million at December 31, 2005, up 10.3% 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, recapitalisation, rapidly growing companies, expansion financings, turnaround situations, and other special equity situations.

With the exception of listed equity investments, where fair value is reliably discernable, investments in equity funds are carried at cost. Provisions for other than temporary decline in value, determined on an individual basis, amounted to US$32.8 million at the reporting year end. During 2005 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 Projects and Equity Participations

Investments in projects and equity participations amounted to US$736.2 million at the end of 2005, compared to US$435.2 million at the end of 2004. A marked increase of 69.2% over previous year. This category includes a mix of investments in unconsolidated GCC and other subsidiaries and equity stakes in GCC companies.

During 2005, the principal investing team made investments in eleven new projects, and conducted exhaustive appraisals for several others. New additions included investments in diversified projects comprising of petrochemical, financial services, metals, telecommunications and information technology.

Net provisions during the year increased by US$5.8 million. The increase resulted from a charge for the year amounting to US$7.7 million and the utilization of provision amounted to US$1.9 million. Detailed analysis of the portfolio and related provisions, is contained in Note 9 to the Financial Statements. A list of the corporation's direct investments is also given on page 74.

Receivable from Shareholders

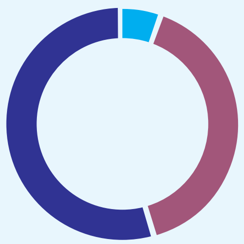
The receivable from shareholders amounted to US$52.4 million at the end of 2005. Subsequent to the sale of Gulf International Bank (GIB) in 2001, US$577.1 million relating to proceeds from the sale was outstanding from the shareholders at 31 December 2001. The outstanding balance earned a competitive rate of return, which was 3.29% for the year 2005. During 2002, 2003, 2004 and 2005 US$524.7 million was repaid by the shareholders towards principal and interest, resulting in a balance of US$52.4 million at 31 December 2005. As demonstrated in the past the shareholders intend to repay this outstanding over the next year through dividends received from the corporation. Note 7 to the Financial Statements provides additional details.

Property and Other Assets

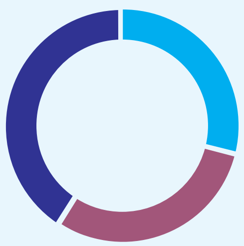
Including property and fixed assets, total other assets amounted to US$186.9 million at 31 December 2005. Of this US$21.9 million related to property and other fixed assets. The remaining US$165.0 million comprised accrued interest and fees receivable, derivative assets used for hedging, employees' end of service benefit asset, accounts receivable, prepaid expenses and other miscellaneous assets. Details are set out in Notes 10 and 11 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 that follows.

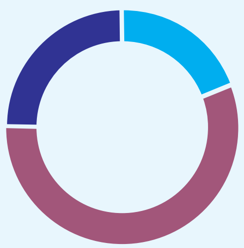
Loans and Credit Funds Maturity Profile



2005



2004



2003

	2005	2004	2003
Within 1 year	**5.4%**	28.9%	18.9%
1 to 5 years	**40.4%**	30.2%	56.6%
Over 5 years	**54.2%**	40.9%	24.5%

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.

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 a 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.

As a part of its ongoing efforts to adopt market best practice standards and equip GIC to successfully face risk management challenges in the future, GIC's risk management team, under the guidance of senior management and the board of directors, initiated a comprehensive review of the corporation's risk management framework in 2005. Internationally reputed external consultants were engaged to conduct a thorough appraisal of the existing systems, with the objective of identifying gaps vis-à-vis global best practices and developing solutions to upgrade to these higher levels where relevant.

The observations from this study confirmed the prevalence of a sound "risk management culture" within the organization combined with adequate systems and tools for the existing levels of business activity. Steps are being taken to fine tune certain aspects, identified during the review, to enhance the risk management process and bring it up to par with international best practices. A significant outcome of this assessment was the decision to implement a quantitative tool for credit risk measurement. The new credit VaR system will supplement the existing market VaR system, enhancing the overall risk measurement capability.

The process of managing the four risk categories identified above 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 breakdown of the principal sources of credit risk is illustrated in the pie chart above. The proportions reflect Credit Risk Weighted Exposure, computed based on BIS capital adequacy guidelines.

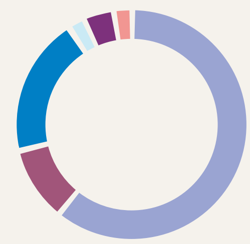
The primary tool used in the management of credit risk is a set of well defined credit policies and procedures. In addition to communicating management's risk appetite in the form of limits for country, product, industry and obligor, these policies detail the process of measurement, monitoring and reporting. 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. During 2005, the risk management team acquired 'Financial Advisor', a software application developed by Moody's, to assist in detailed financial analysis of obligors. This will enable our credit analysis to be more consistent and accurate, forming the basis for a standardized internal rating model.

The credit risk management process utilizes statistical methods as well, to estimate expected and unexpected loss amounts for the various business activities. Although, prudent cost management is a priority at GIC, no effort is spared to have in place cutting edge technology and systems to effectively manage existing or potential risks. In this regard, steps have been taken to implement a Value at Risk (VaR) based credit portfolio quantification tool. The system, based on Creditmetrics methodology, will enable accurate credit measurement on an individual exposure as well as a portfolio basis. Expected and Unexpected loss estimates would be computed based on probabilities of default (PD) and loss given default (LGD) data published by leading rating agencies. The system is expected to be fully functional in early 2006.

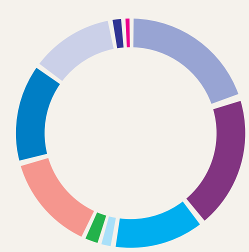
Although, business units are responsible for maintaining exposures within limits, actual exposures are continuously monitored by independent control functions including Risk Management, Financial Control, Compliance and Internal Audit. Technology is a key element in the monitoring process and in this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

Sources of Credit Risk (Weighted Credit Risk Exposure)



Investment Securities	60.5%
Loans and Credit Funds	10.9%
Investment in Projects, Equity participations and Equity funds	19.9%
Placements & other Interest bearing assets	2.7%
Other Asset Categories	3.6%
Off balance sheet	2.4%

Principal Investing (Projects) by Industry



Chemicals	19.7%
Construction Materials	19.3%
Distributors	13.8%
Financial Services	1.9%
Food Products	2.3%
Metals & Mining	14.0%
Diversified	14.2%
Telecommunications	12.2%
Power & Utilities	2.1%
Other	0.5%

As of end 2005, 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$3.6 billion, of the US$4.1 billion investment securities portfolio is made up of high grade debt securities, of which 96% are of issuers rated investment grade or better. Equity investments constitute the remaining 10% of the investment securities portfolio. The superior quality of the portfolio is highlighted in the rating profile on this page. 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 we comprehend well and where we have 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 38, 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 holding within these structured investment vehicles are rated investment grade or better. The corporation's lending activity is being gradually phased out, with the residual balance in the loan book amounting to just US$29.7 million as of 31st December 2005.

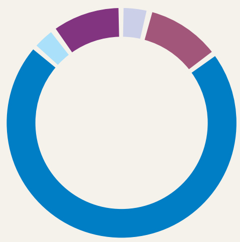
Off-balance sheet Financial Instruments

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 the year end 2005, there were only trading foreign exchange contracts outstanding, 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 30.

Rating Profile - Investment Securities Portfolio



AAA / Aaa rated debt securities	3.9%
GCC Government securities	10.8%
Debt securities of other investment grade issuers	71.4%
Other Debt securities	3.7%
Equities	10.2%

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 on this page for the combined mark-to-market and investment activities. 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 Value at Risk (VaR) concept. Quantitative statistical methods combined with judgment and experience are used to effectively manage market risk. A system of limits and guidelines restrain 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.

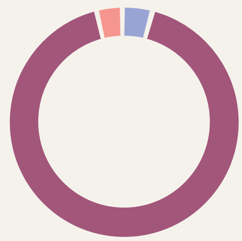
VaR is calculated and reported to senior management on a daily basis at various levels of consolidation including portfolio, business unit and Corporation. The average, minimum and maximum value at risk amounts for the combined mark-to-market and investment activities are tabulated below.

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 below.

At US$37.4 million, the average overall VaR was approximately 65% higher than the level of 2004. The principal contributor to this increase in VaR was a higher equity VaR, resulting from higher exposures to equity markets. Interest rate VaR continued to decrease as a result of effective interest rate hedging. Foreign exchange VaR, as in previous years, remained at relatively low levels. With regards to equity VaR, a significant portion arose from the listed component of GIC's principal investments portfolio. Such equity participations, where the corporation holds a substantial stake, are strategic and long term in nature. 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 2005, the overall VaR was US$43.3 million.

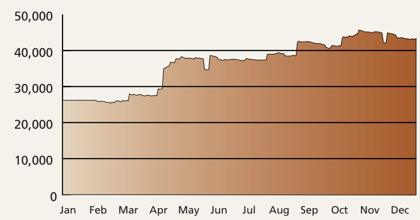
Scenario analysis is an essential component of the market risk management framework. The assumption of normality on which the statistical models are based may become invalid due to the occurrence of certain events. Future scenarios, which result in a breakdown of the historical behavior and relationships 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.

Market Risk Constituents - Overall



Interest Rate Risk	3.9%
Equity Risk	92.5%
Foreign Exchange Risk	3.6%

Profile of daily VaR – 25 day holding period, 95% confidence level (US$000's)



2005 Value at Risk – 25 day holding period, 95% confidence level

US$000's	Average	Minimum	Maximum	31 Dec 2005
Interest rate	1,575	658	2,527	1,368
Equity	37,407	25,331	46,103	43,192
Foreign Exchange	1,445	844	2,263	1,245
Total	37,416	25,353	45,647	43,326

Liquidity Risk

Liquidity risk is the risk of being unable to meet financial obligations at reasonable prices. Liquidity risk arises due to

(1) Cash flow illiquidity, arising from the potential inability to procure funds at reasonable rates and required maturities.

(2) Asset illiquidity, relating to the possibility of having to sell assets on a forced basis.

The corporation adopts a conservative approach to liquidity management with an objective of maintaining sufficient levels of funds and funding capacity to meet our commitments, both on and off balance sheet. In addition to historical data and current information, a vital element in our liquidity measurement methodology is to forecast future scenarios of a tightening in liquidity due to adverse events which may affect both the corporation and the wider financial system. Extreme event scenarios are evaluated both on the assets and liability side.

GIC considers that a strong capital position is integral to its ability to manage liquidity by ensuring its secure and continuous access to deposits from both, customers and banks. Liquidity controls are in place to closely monitor the profile of future cash flows from maturing assets and liabilities to ensure that the resultant liquidity requirements are within prudently established limits.

A measure of the corporation's liquidity coverage is highlighted in the following paragraphs.

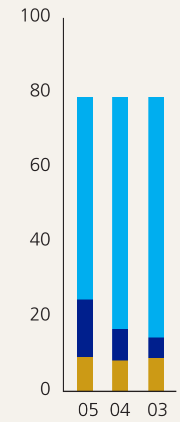
Liquid Assets Ratio

The corporation maintains a high proportion of liquid assets, the majority of which include marketable securities. The liquid asset ratio as of 31st December 2005 was 78.6%. The ratio is computed by determining the proportion of total assets that can be readily converted into cash, without incurring undue capital losses. Liquid assets include bank balances, money market instruments, placements and securities. Investment securities, constituting over 68.3% of the liquid assets, are primarily made up of superior grade debt securities which are readily realizable. GIC's investments in GCC based projects and equity participations, which are listed, are not included within the category of liquid assets above. Such equity holdings that are quoted on the regional stock exchanges significantly enhance the overall liquidity profile.

Diversified sources of funding

Prudent liability management is a vital component of our business strategy and is handled within our treasury operations. In line with our expansion strategy, several initiatives were executed during 2005. Significantly, in early 2005, we successfully completed a five year US$200 million syndicated loan program, augmenting our medium term financing. Following this, the second tranche of the US$1 billion EMTN program was launched in mid 2005, further enhancing our funding profile. In both instances the response from regional and international investors was excellent, enabling competitive pricing. Relative to the previous year end, the corporation's term finance funding has risen by approximately 88% to reach US$1.5 billion at 31st December 2005. Liquidity and funding risk is continuously managed by securing diversified sources of funding and aligning asset and liability maturities, enabling future balance sheet expansion.

Liquid Asset Ratio



	2005	2004	2003
Placements & other liquid assets	9.7%	9.5%	9.1%
Trading securities & managed funds	15.2%	8.1%	6.2%
Investment securities	53.7%	63.6%	64.2%
	78.6%	81.2%	79.5%

The upgrades to GIC'c credit rating, including the ones in 2005 by both Moody's and Standard & Poor's, had a favorable impact on the corporation's funding costs and its ability to establish diversified funding sources, both within the region and across international markets.

As the chart below illustrates, we are continuously trying to achieve an optimal mix of sources of funding.

Another key funding source for GIC is its deposit base. GCC deposits, amounting to 66% of total deposits, forms a stable funding source. At 31st December 2005, deposits from various sources totaled US$2,061.1 million. Over the years, the corporation has applied its marketing skills to develop a reliable source of deposits, both regionally and in international markets. In addition to a stable deposit base, a sizable portfolio of high grade debt securities are available to secure funds through repurchase agreements, should the need arise.

Maturity profile of assets and liabilities

A detailed breakdown of the maturity profile by individual asset and liability category is provided in Note 22 to the Financial Statements. At December 31st 2005, roughly 19.1% of total assets were due to mature within 12 months. Approximately to 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

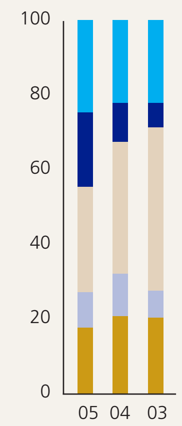
Both the premier global rating agencies upgraded GIC's credit ratings during 2005. Moody's upgraded the corporation's long-term deposit and senior unsecured debt ratings to A2 from Baa1, an enhancement of two notches, identifying the strong ownership structure and unique business model as key strengths. GIC's reputation as a high quality credit counterparty was reaffirmed with Standard & Poor's upgrading our long term ratings to A- from BBB+. Both agencies had a stable outlook for their respective ratings.

We believe that the Corporation's enhanced rating is indicative of a sound business operation and future business potential.

	Moody's	Standard & Poor's
Long-term Deposits	A2	A-
Short-term Deposits	P2	A2
Bank Financial Strength (BFSR)	C-	-

These improved ratings reflect the Corporation's strong capital position, its ownership structure and position in the Gulf region, good profitability, asset quality, loan loss experience, the high level of professionalism of our staff and effective management.

Diversified Source of Funding



	2005	2004	2003
GCC deposits	18.3%	20.7%	19.9%
International deposits	9.4%	11.8%	8.6%
Repo financing	27.4%	34.8%	42.9%
Term financing	20.1%	11.0%	6.9%
Shareholders' funds & others	24.8%	21.7%	21.7%
	100.0%	100.0%	100.0%

Capital Strength

Capital represents the shareholder's 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.

Regulatory Capital

At the end of the year under review, the Total and Tier 1 capital ratios were 25.6% and 22.9% respectively. The corporation's strong capital base was further enhanced during 2005 with the substantial rise in profits and retained earnings. Additionally, the unrealized gain on available for sale securities included in revaluation reserves increased the overall capital base. The ratios are computed based on the Capital Adequacy guidelines of the Basle Committee on Banking Supervision (Basel I), incorporating the capital charge in respect of market risk as well.

With the objective of optimizing capital allocation, GIC has developed a program of phased and gradual growth to be executed over the next few years. This build up will be governed predominantly on risk-return objectives.

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.

BIS Capital Ratio Computations

US$ million	2005	2004	2003
Tier 1 Capital (A)	1,280.1	1,103.8	1,149.3
Total Capital Base (B)	1,429.2	1,190.8	1,203.0
Risk Weighted Exposure (C)	5,585.0	4,967.4	4,119.0
BIS Capital Ratios (%)			
Tier 1 Capital Ratio (A/C*100)	22.9	22.2	27.9
Total Capital Ratio (B/C*100)	25.6	24.0	29.2

Operational Risk

Operational risk is the potential for financial and reputational loss arising from a breakdown in internal controls, operational processes or the various systems that support them. It also includes human errors, criminal acts and natural disasters. Operational risk factors can be categorized into internal and external. Internal risk factors are managed through the establishment of effective segregation of responsibilities, infrastructure and controls within the corporation. External risk factors are managed by anticipating the occurrence of adverse events, preparing contingency plans and implementing sound back-up systems.

Internal Audit & Control

The Internal Audit division plays an important role in the risk management process, particularly in managing operational risk. Operational risk is managed through an effective infrastructure of internal controls including systems and procedures to monitor transactions, positions, confirmations and documentation. The Internal Audit division ensures that these control mechanisms, which cover the front and back office functions, are adhered to and adequately functioning and reports directly to the Audit Committee of the Board of Directors. In addition to internal audits, the corporation's system of internal controls is regularly examined and evaluated by external auditors, as required by the local regulatory body.

The influence of technology has increased substantially over the recent past and this trend is likely to accelerate in future. Keeping this in perspective, considerable resources have been allocated to managing the system side of operational risk. An EDP audit function within the Internal Audit Division works in close conjunction with the Risk Management division to oversee system risk issues.

Financial Statements

Auditors' Report to the Shareholders of Gulf Investment Corporation G.S.C.

We have audited the accompanying balance sheet of Gulf Investment Corporation G.S.C. ("the Corporation") as of December 31, 2005, and the related statements of income, cash flows and changes in equity for the year then ended. These financial statements are the responsibility of the Corporation's management. 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 plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Corporation as of December 31, 2005 and the results of its operations 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.

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 Chairman 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, 2005 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 organisation of banking business, and its related regulations during the year ended December 31, 2005.

Ernst + Young

ERNST & YOUNG
KUWAIT

19 January 2006

(US$ million)	Note	**2005**	2004
ASSETS			
Cash and cash equivalents		**7.5**	10.7
Placements	3	**582.4**	559.3
Securities purchased under resale agreements		**24.6**	-
Trading securities and managed funds	4	**1,129.1**	596.3
Investment securities	5	**4,062.0**	4,636.1
Loans and credit funds	6	**479.7**	491.5
Receivable from shareholders	7	**52.4**	194.2
Equity funds	8	**184.2**	167.0
Investment in projects and equity participations	9	**736.2**	435.2
Property and other fixed assets	10	**21.9**	24.0
Other assets	11	**165.0**	142.3
Total assets		**7,445.0**	7,256.6
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits	12	**2,061.1**	2,357.3
Securities sold under repurchase agreements		**2,039.4**	2,527.7
Term finance	13	**1,500.0**	800.0
Other liabilities	14	**202.3**	250.5
Total liabilities		**5,802.8**	5,935.5
Shareholders' Equity			
Share capital		**750.0**	750.0
Reserves		**610.7**	417.8
Retained earnings		**281.5**	153.3
Total shareholders' equity	15	**1,642.2**	1,321.1
Total liabilities and shareholders' equity		**7,445.0**	7,256.6

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

Shaikh Fahad bin Faisal Al-Thani
Chairman

Hisham Abdulrazzaq Al-Razzuqi
Chief Executive Officer and General Manager

Statement of Income
For the year ended December 31, 2005

(US$ million)	Note	**2005**	2004
Interest and similar income	16	**191.8**	163.9
Interest expense and similar charges	17	**(171.2)**	(102.8)
Investment and other income	18	**309.1**	117.4
Gross operating income		**329.7**	178.5
Provision for impairment losses	19	**(11.4)**	(5.1)
Staff cost		**(28.2)**	(21.0)
Premises		**(2.6)**	(2.5)
Amortisation of goodwill		**-**	(1.5)
Other operating expenses		**(14.7)**	(13.0)
Net income for the year		**272.8**	135.4

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

Statement of Changes in Shareholders' Equity
For the year ended December 31, 2005

(US$ million)	Share capital	Reserves: Compulsory reserve	Voluntary reserve	Investment revaluation reserve	Subtotal reserves	Retained earnings	Total
Balance as at January 1, 2004	750.0	165.8	135.8	114.4	416.0	119.9	1,285.9
Net gains on disposal of investments available for sale transferred to statement of income	-	-	-	(23.0)	(23.0)	-	(23.0)
Change in fair value of available for sale assets	-	-	-	92.9	92.9	-	92.9
Share of investment revaluation reserves of associated companies	-	-	-	4.9	4.9	-	4.9
Total income and expenses for the year recognised directly in equity	-	-	-	74.8	74.8	-	74.8
Net income for the year	-	-	-	-	-	135.4	135.4
Total income for the year	-	-	-	74.8	74.8	135.4	210.2
Transfer to compulsory reserve	-	13.5	-	-	13.5	(13.5)	-
Transfer to voluntary reserve	-	-	13.5	-	13.5	(13.5)	-
Dividend for 2003	-	-	(100.0)	-	(100.0)	(75.0)	(175.0)
Balance as at December 31, 2004	750.0	179.3	49.3	189.2	417.8	153.3	1,321.1
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 21)	-	-	-	-	-	(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**

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

Statement of Cash Flows
For the year ended December 31, 2005

(US$ million)	**2005**	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income for the year	**272.8**	135.4
Adjustments for:		
Income receivable from the shareholders (see note 7)	**(2.5)**	(8.0)
Provision for impairment losses	**11.4**	5.1
Amortisation of goodwill	**-**	1.5
Net gain on sale of investment securities	**(47.2)**	(15.0)
Net gain on sale of investment in projects	**(45.0)**	(0.3)
Income from projects and equity participations	**(88.4)**	(26.2)
Amortisation of premium on investment securities	**13.6**	14.1
Depreciation	**2.7**	2.7
(Increase)/decrease in fair value of available-for-sale investments	**(50.5)**	38.9
Increase in trading securities	**(533.1)**	(175.6)
Decrease in other assets and other liabilities (net)	**30.1**	20.3
Net cash outflow from operating activities	**(436.1)**	(7.1)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Increase in placements	**(24.5)**	(155.6)
(Increase)/ decrease in securities purchased under resale agreements	**(24.6)**	46.5
Decrease/(increase) in loans and credit funds	**12.0**	(45.5)
Sale and maturity of investment securities	**885.3**	893.4
Purchase of investment securities	**(303.7)**	(1,158.5)
Increase in investment in equity funds	**(37.8)**	(21.7)
Sale of investment in projects	**71.3**	0.6
Increase in investment in projects and equity participations	**(114.4)**	(38.7)
Purchase of property and other fixed assets	**(0.6)**	(0.5)
Received from shareholders	**144.4**	213.4
Net cash inflow/(outflow) from investing activities	**607.4**	(266.6)
CASH FLOWS FROM FINANCING ACTIVITIES:		
(Decrease)/increase in deposits and repurchase agreements	**(784.5)**	107.9
Increase in term finance	**700.0**	340.0
Dividend paid	**(90.0)**	(175.0)
Net cash (outflow)/inflow from financing activities	**(174.5)**	272.9
Decrease in cash and cash equivalents	**(3.2)**	(0.8)
Cash and cash equivalents at beginning of year	**10.7**	11.5
Cash and cash equivalents at end of year	**7.5**	10.7

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

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 January 19, 2006.

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 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, and available for sale assets, 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, with the exception of the following policies that have been revised due to the adoption of certain new and revised International Financial Reporting Standards becoming mandatory for financial years beginning on or after January 1, 2005. The principal effects are discussed below:

IFRS 3 Business Combinations, IAS 36 (revised) Impairment of Assets

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. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill already carried in the balance sheet is not amortised after January 1, 2005. Goodwill relating to acquisitions from January 1, 2005 onwards is not amortised.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Basis of presentation (continued)

IFRS 3 Business Combinations, IAS 36 (revised) Impairment of Assets (continued)

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. As at the acquisition date, any goodwill acquired is allocated to each of the cash-generating units expected to benefit from the combination's synergies. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised. Where goodwill forms part of a cash generating unit and a part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

IAS 32 (revised) Financial Instruments: Disclosure and Presentation,
IAS 39 (revised) Financial Instruments: Recognition and Measurement

The Corporation classifies non trading investment securities upon initial recognition into the following categories:

- Held to maturity
- Available for sale
- Financial assets carried at fair value through statement of income

Impairment of investments available for sale

In the case of available for sale equity investments reversal of previously recognised impairment losses are no longer recorded through the statement of income but as increases in cumulative changes in fair value. There was no impact on the statement of income for 2005 as there were no such reversals in that year.

Derecognition of financial assets

With effect from January 1, 2005 a financial asset (in whole or in part) is derecognised either when the Corporation has transferred substantially all the risks and rewards of ownership or when it has neither transferred or retained substantially all the risks and rewards and when it no longer has control over the asset or a proportion of the asset.

2.3 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 investments in Bituminous Products Company Limited (Bitumat), GIC Technology Partnership Co., Gulf Denim FZE, Investel Holdings W.L.L., Gulf Jyoti International, Crown Paper Mill Ltd. and Gulf Paramount for Electrical Services Co 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 9).

2.4 Cash and cash equivalents

Cash and cash equivalents comprise of cash in hand, balances with Central Banks and deposits with banks with maturities less than 7 days.

2.5 Financial Instruments

(i) Classification

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.

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.

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.

(ii) 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 and receivables are recognised on the settlement date.

(iii) Measurement

Financial instruments are measured initially 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 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 2.9).

All non-trading financial liabilities, loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses (see note 2.9). 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 and amortised based on the effective interest rate of the instrument.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 Financial Instruments (continued)

(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 pricing models or discounted cash flow techniques or market price of similar financial instruments.

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 on subsequent measurement

Gains and losses arising from a change in the fair value of investments available for sale are recognised directly in shareholders' 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 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.

2.6 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. 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.

2.7 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 control or influence over the financial and operating policies ("associates") are accounted for using the equity method. Provision is made for any impairment losses and recognised in the statement of income.

Other investments in projects and equity participations are classified as available for sale assets. Provision is made for any impairment losses on an individual investment basis and is recognised as set out in note 2.9.

2.8 Property and other fixed assets

Property and other fixed assets are carried at cost less accumulated depreciation and impairment losses (see note 2.9). 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

2.9 Impairment

Property, other fixed assets, goodwill and financial assets are reviewed at each balance sheet date to determine whether there is an indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

Property, other fixed assets and goodwill

An impairment loss is recognised 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. The impairment losses are recognised in the statement of income.

Financial instruments

Impairment is determined as follows:

(a) for assets carried at amortised cost, impairment is based on estimated cash flows discounted at the original effective interest rate.

(b) for assets carried at fair value, impairment is the difference between cost and fair value.

(c) for assets carried at cost, impairment is the present value of future cash flows discounted at the current market rate of return for a similar financial asset.

For equity investments available for sale reversal of impairment losses are recorded as increases in cumulative changes in fair value through equity.

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

Impairment losses are recognised in the statement of income.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

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 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.

2.12 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 2.5 (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 shareholders' 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 shareholders' equity is removed from shareholders' equity and included in the initial measurement of the asset or liability. Otherwise the cumulative gain or loss recognised in shareholders' 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 shareholders' equity remains in shareholders' 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 shareholders' 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.

2.13 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.

2.14 Foreign currency

The reporting currency of the Corporation is the 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. Foreign currency monetary assets and liabilities 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.

2.15 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 monitor 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.15 Significant accounting judgements and estimates (continued)

Impairment of investments

The Corporation treats investments available for sale 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 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 on a half yearly basis to assess whether a provision for impairment should be recorded in the statement of income. In particular, considerable judgement 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 9. 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, 2005 included placements with non-bank financial institutions amounting to US$ 85.8 million (2004: US$ 20.2 million) shown net of provisions amounting to US$ 1.8 million (2004: nil).

4 TRADING SECURITIES AND MANAGED FUNDS

(US$ million)	**2005**	2004
Trading securities held through managed funds	**610.5**	100.1
Other investments held through managed funds	**518.6**	496.2
	1,129.1	596.3

Other investments held through managed funds are classified as “fair value through statement of income”.

5 INVESTMENT SECURITIES

(US$ million)	**2005**	2004
Debt and other interest bearing instruments available for sale		
AAA/Aaa rated debt securities	**145.4**	213.4
GCC Government securities	**294.1**	166.5
Debt securities of other investment grade issuers	**2,818.9**	3,452.8
Other debt securities	**142.4**	99.9
	3,400.8	3,932.6
Debt and other interest bearing instruments held to maturity		
AAA/Aaa rated debt securities	**12.1**	36.3
GCC Government securities	**146.0**	106.6
Debt securities of other investment grade issuers	**82.1**	282.5
Other debt securities	**6.2**	5.5
	246.4	430.9
Equity investments available for sale		
Listed equity investments	**136.8**	97.3
Unlisted equity investments	**278.0**	175.3
	414.8	272.6
Total	**4,062.0**	4,636.1
Analysis of debt securities:		
Instruments bearing interest at fixed rates	**194.9**	480.0
Instruments bearing interest at floating rates	**3,452.3**	3,883.5
	3,647.2	4,363.5

Investment securities amounting to US$ 2,014.8 million (2004: US$ 2,527.7 million) are pledged as security in respect of borrowings under securities sold under repurchase agreements.

During the year a provision of US$ 1.0 million on investment securities held to maturity was released (2004: US$ 1.1 million). The Investments shown above are net of provisions.

6 LOANS AND CREDIT FUNDS

(US$ million)	**2005**	2004
Loans and advances to customers	**29.7**	41.5
Credit funds	**450.0**	450.0
	479.7	491.5

There were no significant concentrations by industrial sector at December 31, 2005 or at December 31, 2004.

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

a) Provision for loan losses

(US$ million)	**2005**	2004
Balance at beginning of year	**3.4**	3.6
Amounts utilised	**(1.7)**	-
Net write back for the year	**(0.1)**	(0.2)
Balance at end of year	**1.6**	3.4

b) Provision for loan guarantees

(US$ million)	**2005**	2004
Balance at beginning of year	**3.5**	3.6
Net write back for the year	**(1.0)**	(0.1)
Balance at end of year	**2.5**	3.5

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 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

This primarily represents the unpaid balance from the sale of Gulf International Bank ("GIB") to the Corporation's shareholders on April 7, 2001. Repayment of this outstanding balance will be from any future dividends received by the shareholders from GIB and from the Corporation. The outstanding balance carries a rate of return to be computed annually. The rate for 2005 was 3.29% (2004: 3.64%).

8 EQUITY FUNDS

(US$ million)	**2005**	2004
Listed equity investments	**6.0**	26.9
Unlisted equity investments	**211.0**	167.9
	217.0	194.8
Provision for impairment	**(32.8)**	(27.8)
	184.2	167.0

Unlisted equity securities held by the 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)	**2005**	2004
Balance at beginning of year	**27.8**	22.0
Net charge for the year	**5.0**	5.8
Balance at end of year	**32.8**	27.8

9 INVESTMENT IN PROJECTS AND EQUITY PARTICIPATIONS

(US$ million)	**2005**	2004
Project investments equity accounted	**320.6**	195.4
Other project investments and equity participations	**439.1**	265.7
Goodwill	**36.3**	28.1
	796.0	489.2
Provision for impairment	**(59.8)**	(54.0)
	736.2	435.2

Provision for impairment consists of provision for investments equity accounted of US$ 4.3 million (2004: US$ 1.9 million) and provision for impairment of other project investments and equity participations of US$ 55.5 million (2004: US$ 52.1 million).

Included in equity participations are investments in subsidiary companies with a carrying value of US$ 70.1 million (2004: US$ 26.0 million). The aggregate carrying value of assets and liabilities in these subsidiaries and respective items of income and expense are not material to the financial statements. These investments contributed profit of US$ 7.7 million (2004: US$ 5.7 million) to the Corporation.

9 INVESTMENT IN PROJECTS AND EQUITY PARTICIPATIONS (continued)

a) Other project investments and equity participations

(US$ million)	**2005**	2004
Listed investments	**247.7**	148.6
Unlisted investments	**191.4**	117.1
	439.1	265.7

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.

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

The movement in the provisions are as follows:

(US$ million)	**2005**	2004
Balance at beginning of year	**54.0**	55.6
Amounts utilised	**(1.9)**	(2.3)
Net charge for the year	**7.7**	0.7
Balance at end of year	**59.8**	54.0

10 PROPERTY AND OTHER FIXED ASSETS

(US$ million)	Cost	Accumulated depreciation	**2005 Net book value**	2004 Net book value
Building and installations	28.8	8.4	**20.4**	22.1
Furniture, equipment and motor vehicles	9.4	7.9	**1.5**	1.9
	38.2	16.3	**21.9**	24.0

There were no significant additions or disposals during the year. The depreciation charge for the year is US$ 2.7 million (2004: US$ 2.7 million).

11 OTHER ASSETS

(US$ million)	**2005**	2004
Accrued interest, fees and commissions	**98.3**	94.6
Derivative assets used for hedging	**21.6**	6.8
Employees' end of service benefit asset	**34.9**	32.4
Prepayments	**0.6**	1.0
Other, including accounts receivable	**9.6**	7.5
	165.0	142.3

12 DEPOSITS

(US$ million)	2005	2004
Deposits from Central Banks	**422.1**	409.7
Deposits from other banks	**1,042.3**	1,202.5
Islamic deposits	**303.7**	392.5
Other deposits	**293.0**	352.6
	2,061.1	2,357.3

At December 31, 2005 deposits from GCC Country Governments, Central Banks and other government institutions headquartered in the GCC States amounted to US$ 1,360.0 million (2004: US$ 1,502.6 million).

13 TERM FINANCE

(US$ million)	2005	2004
GIC US Dollar floating rate note due in 2007	**300.0**	300.0
GIC Euro medium term floating rate note due in 2009	**500.0**	500.0
GIC Euro medium term floating rate note due in 2010	**500.0**	-
US Dollar floating rate term loan due in 2010	**200.0**	-
	1,500.0	800.0

14 OTHER LIABILITIES

(US$ million)	2005	2004
Accrued interest	**77.9**	87.2
Derivative liabilities used for hedging	**63.4**	111.7
Employees' end of service benefits	**37.9**	35.4
Other provisions	**2.4**	3.5
Other, including accounts payable and accrued expenses	**20.7**	12.7
	202.3	250.5

15 SHAREHOLDERS' EQUITY

15.1 The authorised and issued capital comprises of 2.1 million shares of US$ 1,000 each (2004: 2.1 million shares of US$ 1,000 each). The paid up capital is US$ 750 million (2004: US$ 750 million).

15.2 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.

15.3 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.

15 SHAREHOLDERS' EQUITY (continued)

15.4 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.

16 INTEREST AND SIMILAR INCOME

(US$ million)	2005	2004
Placements	**27.2**	14.3
Securities	**134.9**	124.1
Loans and credit funds	**27.2**	17.5
Receivable from shareholders	**2.5**	8.0
	191.8	163.9

17 INTEREST EXPENSE AND SIMILAR CHARGES

(US$ million)	2005	2004
Deposits	**68.1**	40.6
Securities sold under repurchase agreements	**53.6**	50.5
Term finance	**49.5**	11.7
	171.2	102.8

Included in interest expense is US$ 24.1 million (2004: US$ 13.9 million) relating to interest incurred on liabilities to fund non interest bearing assets.

18 INVESTMENT AND OTHER INCOME

(US$ million)	2005	2004
Net gain on trading securities and managed funds	**60.6**	34.3
Net gain on sale of investment securities	**47.2**	16.0
Net gain on sale of investment in projects and equity participations	**45.0**	0.3
Income from equity funds	**26.7**	15.8
Income from projects and equity participations	**89.1**	26.2
Profit on foreign exchange	**0.4**	0.3
Dividend income	**21.6**	10.4
Fees, commissions and sundry income	**18.5**	14.1
	309.1	117.4

Net gain on disposal of available for sale investments transferred from revaluation reserve in shareholders' equity amounting to US$ 90.7 million (2004: US$ 23.0 million) are included under respective categories.

19 PROVISION FOR IMPAIRMENT LOSSES

(US$ million)	**2005**	2004
Placements with non-bank financial institutions	**(1.8)**	-
Equity funds	**(5.0)**	(5.8)
Projects and equity participations	**(7.7)**	(0.7)
Loans and loan guarantees	**1.1**	0.3
Investment securities – held to maturity	**1.0**	1.1
Accounts receivable	**1.0**	-
	(11.4)	(5.1)

20 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, 2005 amounted to US$ 3.8 million (2004: US$ 3.4 million).

21 DIVIDEND

The Board of Directors have recommended a dividend of 23.6% on paid up capital for the year ended December 31, 2005 (2004: 12%). These will be partially utilised to settle receivable from shareholders (see note 7).

22 RISK MANAGEMENT

22.1 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.

22 RISK MANAGEMENT (continued)

22.1 Liquidity risk (continued)

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, 2005					
Assets					
Cash and cash equivalents	7.5	-	-	-	7.5
Placements	474.8	107.6	-	-	582.4
Securities purchased under resale agreements	24.6	-	-	-	24.6
Trading securities and managed funds	-	-	-	1,129.1	1,129.1
Investment securities	202.4	390.1	1,966.1	1,503.4	4,062.0
Loans and credit funds	13.4	12.5	193.8	260.0	479.7
Receivable from shareholders	52.4	-	-	-	52.4
Equity funds	3.7	7.5	41.1	131.9	184.2
Investments in projects and equity participations	-	-	-	736.2	736.2
Property and other fixed assets	-	-	-	21.9	21.9
Other assets	77.7	49.0	3.5	34.8	165.0
Total assets	**856.5**	**566.7**	**2,204.5**	**3,817.3**	**7,445.0**
Liabilities and shareholders' equity					
Deposits	1,949.1	90.8	21.2	-	2,061.1
Securities sold under repurchase agreements	1,741.3	298.1	-	-	2,039.4
Term finance	-	-	1,500.0	-	1,500.0
Other liabilities	77.9	31.9	28.0	64.5	202.3
Shareholders' equity	-	-	-	1,642.2	1,642.2
Total liabilities and shareholders' equity	**3,768.3**	**420.8**	**1,549.2**	**1,706.7**	**7,445.0**
At December 31, 2004					
Total assets	**1,043.3**	**738.8**	**2,520.8**	**2,953.7**	**7,256.6**
Total liabilities and shareholders' equity	**4,206.5**	**890.4**	**800.0**	**1,359.7**	**7,256.6**

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 to	3 months 1 year	1 to 5 years	Over 5 years	Total
At December 31, 2005					
Assets					
Cash and cash equivalents	7.5	-	-	-	7.5
Placements	474.8	107.6	-	-	582.4
Securities purchased under resale agreements	24.6	-	-	-	24.6
Trading securities and managed funds	1,126.9	-	-	2.2	1,129.1
Investment securities	4,000.2	-	-	61.8	4,062.0
Loans and credit funds	13.4	12.5	193.8	260.0	479.7
Receivable from shareholders	52.4	-	-	-	52.4
Equity funds	3.7	7.5	41.1	131.9	184.2
Investments in projects and equity participations	247.7	-	-	488.5	736.2
Property and other fixed assets	-	-	-	21.9	21.9
Other assets	77.7	49.0	3.5	34.8	165.0
Total assets	**6,028.9**	**176.6**	**238.4**	**1,001.1**	**7,445.0**
Liabilities and shareholders' equity					
Deposits	1,949.1	90.8	21.2	-	2,061.1
Securities sold under repurchase agreements	1,741.3	298.1	-	-	2,039.4
Term finance	-	-	1,500.0	-	1,500.0
Other liabilities	77.9	31.9	28.0	64.5	202.3
Shareholders' equity	-	-	-	1,642.2	1,642.2
Total liabilities and shareholders' equity	**3,768.3**	**420.8**	**1,549.2**	**1,706.7**	**7,445.0**
At December 31, 2004					
Total assets	**6,145.8**	**159.6**	**269.2**	**682.0**	**7,256.6**
Total liabilities and shareholders' equity	**4,206.5**	**890.4**	**800.0**	**1,359.7**	**7,256.6**

22.2 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.

22 RISK MANAGEMENT (continued)

22.2 Interest rate risk (continued)

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 years	Non-interest bearing items	Total	Effective interest rate%
At December 31, 2005						
Assets						
Cash and cash equivalents	7.5	-	-	-	7.5	3.95
Placements	474.8	107.6	-	-	582.4	4.84
Securities purchased under resale agreements	24.6	-	-	-	24.6	2.17
Trading securities and managed funds	255.7	-	-	873.4	1,129.1	3.75
Investment securities :						
Fixed rate	59.2	80.7	55.0	(0.6)	194.3	5.88
Floating rate	1,982.5	1,470.4	-	-	3,452.9	3.89
Equities & Funds	-	-	-	414.8	414.8	-
Loans and credit funds	395.5	84.8	-	(0.6)	479.7	4.04
Receivable from shareholders	52.4	-	-	-	52.4	3.29
Equity funds	-	-	-	184.2	184.2	-
Investment in projects and equity participations	-	-	-	736.2	736.2	-
Property and other fixed assets	-	-	-	21.9	21.9	-
Other assets	-	-	-	165.0	165.0	-
Total assets	**3,252.2**	**1,743.5**	**55.0**	**2,394.3**	**7,445.0**	
Liabilities and shareholders' equity						
Deposits	1,949.1	90.8	21.2	-	2,061.1	3.97
Securities sold under repurchase agreements	1,741.3	298.1	-	-	2,039.4	2.99
Term finance	1,500.0	-	-	-	1,500.0	4.83
Other liabilities	-	-	-	202.3	202.3	-
Shareholders' Equity	-	-	-	1,642.2	1,642.2	-
Total liabilities and shareholders' equity	**5,190.4**	**388.9**	**21.2**	**1,844.5**	**7,445.0**	
Derivative instruments	321.8	(321.8)	-	-	-	-
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)**	**-**	**-**	
At December 31, 2004						
Interest rate sensitivity gap	(1,098.3)	897.3	137.6	63.4	-	
Cumulative interest rate sensitivity gap	**(1,098.3)**	**(201.0)**	**(63.4)**	**-**	**-**	

22.3 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$ millions)	**2005 Equivalent long (short)**	2004 Equivalent long (short)
UAE Dirhams	**8.9**	0.1
Kuwaiti Dinars	**10.4**	21.5
Omani Riyal	**7.7**	6.2
Qatari Riyal	**10.2**	11.8
Saudi Riyal	**210.0**	34.9

22.4 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.

22.5 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.

22.6 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 23.

22 RISK MANAGEMENT (continued)

22.6 Credit risk and concentration of assets, liabilities and off balance sheet items (continued)

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 industry sector was as follows:

	2005		2004	
(US$ million)	**Assets**	**Credit commitments**	Assets	Credit commitments
Geographic region:				
GCC	**2,493.9**	**63.3**	2,077.9	56.3
Other Middle East and North Africa	**22.4**	**-**	44.9	-
Europe	**2,234.0**	**-**	2,437.6	-
North America	**2,548.5**	**-**	2,508.8	-
Asia	**146.2**	**-**	187.4	-
	7,445.0	**63.3**	7,256.6	56.3
Sector:				
Banks and financial institutions	**4,744.4**	**-**	4,021.0	-
Trading and manufacturing	**1,423.5**	**58.0**	1,799.9	56.3
Utilities	**437.5**	**5.3**	391.7	-
Government and Government agencies	**718.5**	**-**	961.1	-
Other	**121.1**	**-**	82.9	-
	7,445.0	**63.3**	7,256.6	56.3

23 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 and the risk-weighted equivalents calculated in accordance with the capital adequacy guidelines of the Bank for International Settlements.

Credit Risk Amounts

	2005		2004	
(US$ million)	**Notional principal amount**	**Risk-weighted equivalent**	Notional principal amount	Risk-weighted equivalent
Transaction-related contingent items	**59.3**	**59.3**	50.2	50.2
Undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	**4.0**	**1.0**	6.1	1.5
	63.3	**60.3**	56.3	51.7

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)	**2005**	2004
Undrawn commitments in investments in equity funds	**183.1**	153.9
Undrawn commitments in investments in projects and equity participations	**33.5**	138.3
	216.6	292.2

24 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$ 2,247.7 million (2004: US$ 2,415.3 million) and its net fair value was a swap loss of US$ 61.8 million (2004: US$ 113.2 million). The corresponding gain on the hedged fixed income securities amounted to US$ 59.4 million (2004: US$ 110.2 million).

24 DERIVATIVES AND FOREIGN EXCHANGE PRODUCTS (continued)

Trading activities

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

(US$ million)	Notional amounts	Net fair values	Credit risk amounts
As at December 31, 2005			
Foreign exchange contracts:			
Unmatured spot, forward and futures contracts	**1,407.4**	**2.4**	**3.3**
As at December 31, 2004			
Foreign exchange contracts:			
Unmatured spot, forward and futures contracts	1,156.5	0.9	1.1
Interest rate contracts:			
Interest rate swaps	27.9	-	0.1
	1,184.4	**0.9**	**1.2**

Counterparty analysis

(US$ million)	Banks	Total
At December 31, 2005		
Credit risk amounts		
OECD countries	3.1	3.1
GCC countries	0.2	0.2
	3.3	**3.3**
At December 31, 2004		
Credit risk amounts		
OECD countries	1.0	1.0
GCC countries	0.2	0.2
	1.2	**1.2**

Maturity analysis

(US$ million)	Year 1	Total
At December 31, 2005		
Notional amounts		
Foreign exchange contracts	**1,407.4**	**1,407.4**
At December 31, 2004		
Notional amounts		
Foreign exchange contracts	1,156.5	1,156.5
Interest rate contracts	27.9	27.9
	1,184.4	**1,184.4**

25 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 5), whose fair value is US$ 3.2 million higher than their carrying value (2004: US$ 7.4 million higher than their carrying value) and certain unlisted equity securities whose fair value cannot be reliably determined (see note 8 and note 9).

Fair value is the amount at which an asset, liability or financial instrument could be exchanged or settled between knowledgeable parties in an arm's length transaction. Underlying the definition of fair value is the presumption that the Corporation is a going concern without any intention, or need, to liquidate, curtail materially the scale of its operations or undertake a transaction on adverse terms.

26 RELATED PARTY TRANSACTIONS

Related parties represent affiliated companies, directors and key management personnel of the Corporation, and companies of which they are principal owners. 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 (2004: Nil).

Receivable from shareholders and interest income on receivable from shareholders are disclosed in notes 7 and 16 respectively.

Compensation of key management personnel

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

(US$ million)	2005
Short-term employee benefits	**4.3**
Post employment and termination benefits	**0.8**
	5.1

Included in other assets are loans to key management personnel amounting to US$ 0.2 million.

27 FIDUCIARY ACTIVITIES

At December 31, 2005 third party assets under management amounted to US$ 538.2 million (2004: US$ 351.3 million). These assets are managed in a fiduciary capacity and are therefore excluded from the balance sheet.

28 COMPARATIVES

Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year. Such reclassifications do not affect previously reported profit or equity.

Direct Investment

(US$ million)	Location	Total Shareholders' Equity	GIC's Share of Capital (%)
Non-consolidated subsidiaries and associated companies			
Bituminous Products Company Limited (Bitumat)	Saudi Arabia	19.0	100.0
Gulf Denim Limited	UAE	7.7	100.0
Investel Holdings WLL	Bahrain	21.2	100.0
Gulf Paramount for Electrical Services Company WLL	Kuwait	3.9	92.8
GIC Technology Partnership Co.	Kuwait	5.1	80.0
Gulf Jyoti International	UAE	6.0	70.0
Crown Paper Mill Ltd. FZC	UAE	20.1	51.0
Delta Gulf Services FZ-LLC	UAE	0.5	50.0
Gulf Industrial Investment Co. (E.C.)	Bahrain	117.4	50.0
Oman Investment Co.	Oman	26.0	50.0
Gulf Electronic Tawasul Company KSCC	Kuwait	5.1	47.5
Al Ezzel Power Company B.S.C.	Bahrain	0.7	45.0
Bahrain Industrial Pharmaceutical Co.	Bahrain	1.8	40.0
The National Titanium Dioxide Co., Ltd. (CRISTAL)	Saudi Arabia	134.2	33.0
A'Saffa Poultry Farms Co. SAOG	Oman	5.3	30.9
United Stainless Steel Company B.S.C. (Closed)	Bahrain	59.8	30.0
Jeddah Cable Company	Saudi Arabia	62.8	25.0
Kuwait International Advanced Industries Company K.S.C.	Kuwait	11.9	25.0
Oman Fiber Optic Co. SAOG	Oman	13.2	25.0
Technical Supplies & Services Co. Ltd.	UAE	20.3	25.0
Interplast Company Limited - (L.L.C.)	UAE	95.5	23.5
Celtex Weaving Mills Co. Ltd.	Bahrain	5.1	23.0
Rawabi Emirates (PJSC)	UAE	62.3	22.5
Advanced Electronics Company Ltd.	Saudi Arabia	49.6	20.0
Gulf Stone Company SAOG	Oman	3.2	20.0
Oman Polypropylene LLC	Oman	56.8	20.0
Wataniya Telecom Algerie S.P.A.	Algeria	112.1	20.0
Equity Participations			
Arab Pesticide Industries Co. (MOBEED)	Saudi Arabia	4.5	12.5
National Petrochemical Industrialization Co. (NPIC)	Saudi Arabia	698.1	12.0
Arab Qatari Co. for Dairy Production	Qatar	16.8	10.8
National Aluminium Products Co. (SAOG)	Oman	12.9	10.0
Al Salam Aircraft Company	Saudi Arabia	76.5	10.0
Gulf Ferro Alloys Company (SABAYEK)	Saudi Arabia	57.9	10.0
Ras Laffan Power Company Limited (Q.S.C.)	Qatar	121.9	10.0
Rasameel Structured Finance Co.	Kuwait	102.7	10.0
Securities and Investment Company B.S.C.	Bahrain	67.4	8.0
Jubail Chemical Industries Company (JANA)	Saudi Arabia	66.0	7.5
Jarir Marketing Co.	Saudi Arabia	135.9	6.8
Zamil Industrial Investment Co.	Saudi Arabia	156.6	6.7
Gulf Aluminium Rolling Mill Co. B.S.C.	Bahrain	115.0	5.9
Arabian Industrial Fibers Company (IBN RUSHD)	Saudi Arabia	456.2	4.7
United Power Company SAOG	Oman	122.6	2.3
Al-Razzi Holding Company K.S.C.	Kuwait	171.2	2.0
Thuraya Satellite Telecommunications Company PJSC	UAE	370.8	1.6
Yanbu National Petrochemical Co. (Yansab)	Saudi Arabia	1,498.9	0.9
Qatar Telecom (Qtel) Q.S.C.	Qatar	1,177.6	0.5

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 markets.
3 Gulf Islamic Fund / US$	December 2005	• Achieve capital appreciation through investment in securities listed or to be listed in the GCC equity markets, that are compliant with the Islamic Sharia regulations.
4 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.
5 GIC KD Bond Fund / KD	May 2003	• Maximize current income and price appreciation consistent with preservation of capital and lower volatility through in debt issues in Kuwaiti markets.
GLOBAL FUNDS		
1 GIC Global REITS Fund / US$	December 2005	• Deliver capital appreciation through investments in Real Estate securities listed in US, Europe and Asian equity markets. • Achieve competitive and stable returns.
2 Alternative Strategies Fund / US$	August 1999	• A fund of Hedge Funds well diversified across a broad mix of styles and strategies. • Achieve annual total returns in the range of LIBOR plus 3% to 5%. • Provide returns with low volatility of 3% to 5%. • Provide returns with low correlation to traditional equity, fixed income and credit markets. • Provide capital preservation even in negative market conditions.
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 5% to 7%. • 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 international 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 11.25% 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

Head of Global Markets
Petri Tapani Kuusisto

Head of Debt Capital Markets
Abdulaziz Al-Mulla

Head of Treasury
Mahmood Al-Aradi

Funding & Liquidity
Martin Joy

Money Markets
Mathew Abraham

Head of Business Development
Malek Al-Ajeel

Head of Managed Funds
Sean Daykin

Head of GCC Equities
Talal Al-Tawari

GCC Fund Management
Waleed Al-Braikan

Principal Investing

Head of Utilities and Financial Services and Corporate Finance
Shafic Ali

Head of Corporate Finance
Mahmoud Rateb

Head of Manufacturing Projects
Khaled Al-Qadeeri

Head of GCC Diversified Projects
Mohammad Al-Melhem

Finance & Administration

Acting Head of Human Resources and Administration
Hani Al-Shakhs

Head of Information Technology
Hani Al-Shakhs

Head of Financial Control
Hazem El-Rafie

Head of Operations
Shawki Khalaf

Head of Communications & Public Relations
Qais Al-Shatti

Corporate Office

Head of Economics & Strategy
Dr. Soliman Demir

Head of Risk Management
Nabil Guirguis

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Hamdy El-Sayed

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Page 35 – Abdul Rahman Al Nuaimi, Oman.

Page 36 – Abdul Raheem Salem, UAE.

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