

Financial Statements and Auditors' Report

For the Year ended 31 December 2006

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Board of Directors' Report

The Directors have pleasure in presenting their report together with the audited consolidated financial statements of National Bank of Kuwait S.A.K. ("the Bank") and its subsidiaries (collectively "the Group") for the year ended 31 December 2006.

2006 Financial Performance

The Group reported a net profit after minority interests of KD 253.2 million in 2006, a 23.2% increase over the 2005 reported net profit of KD 205.6 million.

Net interest income was KD 261.6 million, a 19.1% increase from the 2005 level of KD 219.7 million. This reflects a general increase in interest rates and a significant growth in business volumes and product mix during 2006.

Non interest income for 2006 increased by 45.6% to reach KD 133.5 million compared to KD 91.7 million for 2005. Fees and commissions increased by 36.4% to KD 87.7 million in 2006 from KD 64.3 million in 2005 reflecting the Board's strategy of diversifying its non-interest revenue streams across the Group. Net gains from investment securities increased by 128.3% to KD 24.7 million compared to KD 10.8 million in 2005.

Operating expenses increased by 35.5% to KD 98.9 million in 2006 compared to KD 73 million in 2005. This was due to higher staff expenses and other costs and reflected in part, the Group's wider geographical expansion in the last couple of years. Group staff numbers increased by 458 across all locations and business segments to accommodate increased business needs and to help sustain long term value for the Group. Despite the increase in costs, the cost to income ratio remains a very healthy 25%.

Provisions for credit losses were KD 30.8 million in 2006 compared to KD 23.7 million for 2005 which largely reflects the growth in the loan portfolio. The Group makes a 2% general provision against all outstanding credit facilities (cash and non-cash) net of certain restricted categories of collateral, in accordance with Central Bank of Kuwait regulations.

The Group saw an increase in the amounts paid in taxes and contributions to various Kuwaiti authorities and overseas tax authorities as a result of higher profits across all business units and geographical locations.

2006 Balance Sheet

Total assets of the Group were KD 7,898.3 million at the end of 2006, an increase of 27.4% from KD 6,200.3 million at the end of 2005. The main drivers of growth were loans and advances which increased by 28.1% to KD 4,309.8 million at 2006 year end.

In accordance with the policies of the Central Bank of Kuwait on provisioning for credit losses, the Group's general provision relating to on balance sheet credit facilities increased to KD 83.6 million from KD 64.8 million in 2005, while specific provisions were KD 44.3 million at 2006 year end compared to KD 42.3 million at 2005 year end. The Group continues to maintain a conservative credit policy with a balanced diversification across all business sectors and geographical areas. The high quality of the Group's loan portfolio is reflected by the ratio of non-performing loans (NPL) to gross loans which has fallen to 1.2% at 2006 year end from 1.4% at 2005 year end. NPL coverage by provisions was 239.7% up from 223.5% at 2005 year end.

The Group continues to maintain a strong liquidity position with cash, short term funds, Central Bank of Kuwait bonds and Kuwait Government treasury bonds increasing by 43.2% to KD 1,525.6 million at 2006 year end compared to KD 1,065.6 million at 2005 year end. Deposits with banks and financial institutions increased by 16.2% to KD 1,219.5 million at 2006 year end compared to KD 1,049.3 million at 2005 year end.

Customer deposits increased by 10.7% to KD 4,378.5 million at 2006 year end compared to KD 3,956.5 million for 2005. The Group benefits from a loyal Kuwait consumer base whose deposits are a continuing source of stable funding which finances the growing asset book. Due to banks and financial institutions increased by 74.1% to KD 2,301.9 million at 2006 year end compared to KD 1,322.3 million at 2005.

Cash and non-cash credit facilities provided by the Bank to members of the Board of Directors and to related parties amounted to KD 270.2 million at 2006 year end against a collateral of KD 444.1 million. Deposits of Board members and related parties were KD 31.7 million. Loans and facilities to the Bank's executive management amounted to KD 388 thousand while deposits of the Bank's executive management amounted to KD 948 thousand.

Equity Attributable to the Shareholders of the Bank

Total shareholders equity, attributable to the shareholders of the Bank excluding the proposed cash dividend of KD 145 million but including the proposed bonus share issue of KD 9.8 million, increased by 39.3% at the end of 2006 to KD 914.8 million from KD 656.6 million at the end of 2005. The increase in shareholders equity includes a rights issue of shares in November 2006 where 162,528,830 shares were issued to shareholders at KD 1.100 per share. The rights issue resulted in an increase in issued share capital of KD 16.3 million and an increase in the share premium account of KD 162.5 million.

The Basel II capital adequacy ratio at the 2006 year end was 19.2% compared to the minimum 12% prescribed by the Central Bank of Kuwait.

Bonus Shares, Dividends and Proposed Appropriations

The net profit for the year was principally allocated as follows:

1. KD 145 million to the dividend account for the distribution of a cash dividend of 75 fils per share (70 fils in 2005) subject to the approval of shareholders at the annual general meeting.
2. KD 9.8 million to the share capital account to cover the issuance of bonus shares equal to 5% of share capital at the end of 2006 (equivalent to 97,517,298 shares with a nominal value of 100 fils per share) subject to the approval of shareholders at the annual general meeting.
3. KD 16.2 million to the statutory reserve account to increase the balance to the minimum requirement of 50% of share capital.
4. KD 82.2 million to retained earnings.

Important Growth and Performance Indicators

| | 2006 | 2005 | 2004 |
|---|---------|---------|---------|
| Total assets (KD'm) | 7,898.3 | 6,200.3 | 5,573.0 |
| Loans and advances to customers (KD'm) | 4,309.8 | 3,363.7 | 2,744.7 |
| Customer deposits (KD'm) | 4,378.5 | 3,956.5 | 3,244.6 |
| Total operating income (KD'm) | 395.2 | 311.5 | 230.5 |
| Profit attributable to the shareholders of the parent bank (KD'm) | 253.2 | 205.6 | 150.3 |
| Return on average assets | 3.6% | 3.5% | 2.7% |
| Non interest income to total income | 33.8% | 29.4% | 33.9% |
| Capital adequacy Basel II Ratio | 19.2% | 17.1% | N/A |
| Non performing loans as a % of gross loans | 1.2% | 1.4% | 1.5% |
| Loan loss reserve as a % of non performing loans | 239.7% | 223.5% | 199.9% |

Consolidated Statement of Income

For the year ended 31 December 2006

| | Notes | 2006 KD 000's | 2005 KD 000's | 2006 USD 000's | 2005 USD 000's |
|---|-------|------------------|------------------|-------------------|-------------------|
| Interest income | 4 | 478,162 | 331,092 | 1,653,739 | 1,145,093 |
| Interest expense | 5 | 216,526 | 111,344 | 748,862 | 385,087 |
| Net interest income | | 261,636 | 219,748 | 904,877 | 760,006 |
| Fees and commissions | | 87,689 | 64,300 | 303,275 | 222,384 |
| Net gains from investment securities | | 24,725 | 10,828 | 85,512 | 37,449 |
| Net gains from dealing in foreign currencies | | 15,509 | 13,086 | 53,638 | 45,258 |
| Dividend income | | 2,292 | 1,766 | 7,927 | 6,108 |
| Share of profit of associate | 10 | 2,411 | 1,457 | 8,339 | 5,039 |
| Other income | | 894 | 278 | 3,092 | 961 |
| Operating income | | 395,156 | 311,463 | 1,366,660 | 1,077,205 |
| Staff expenses | | 56,791 | 43,750 | 196,413 | 151,311 |
| Other administrative expenses | | 38,330 | 26,310 | 132,566 | 90,994 |
| Depreciation | | 3,741 | 2,916 | 12,938 | 10,085 |
| Operating expenses | | 98,862 | 72,976 | 341,917 | 252,390 |
| Operating profit before provision for credit losses | | 296,294 | 238,487 | 1,024,743 | 824,815 |
| Provision charge for credit losses - specific | 7 | 8,299 | 5,760 | 28,703 | 19,921 |
| Provision charge for credit losses - general | 7 | 22,531 | 17,913 | 77,924 | 61,953 |
| Operating profit | | 265,464 | 214,814 | 918,116 | 742,941 |
| National labour support tax | | 6,074 | 4,811 | 21,007 | 16,639 |
| Contribution to KFAS | | 2,394 | 1,989 | 8,280 | 6,879 |
| Taxation on overseas branches and subsidiaries | | 3,189 | 2,112 | 11,029 | 7,304 |
| Net profit for the year | | 253,807 | 205,902 | 877,800 | 712,119 |
| Attributable to: | | | | | |
| Shareholders of the parent Bank | | 253,235 | 205,612 | 875,822 | 711,116 |
| Minority interests | | 572 | 290 | 1,978 | 1,003 |
| | | 253,807 | 205,902 | 877,800 | 712,119 |
| Basic and diluted earnings per share attributable to shareholders of the parent Bank | 21 | 136 Fils | 111 Fils | 47 Cents | 38 Cents |

The attached notes 1 to 29 form part of these consolidated financial statements.

Consolidated Balance Sheet

As of 31 December 2006

| | Notes | 2006 KD 000's | 2005 KD 000's | 2006 USD 000's | 2005 USD 000's |
|---|-------|------------------|------------------|-------------------|-------------------|
| Assets | | | | | |
| Cash and short term funds | 6 | 845,618 | 580,434 | 2,924,597 | 2,007,450 |
| Central Bank of Kuwait bonds | | 89,348 | 9,900 | 309,013 | 34,239 |
| Kuwait Government treasury bonds | | 590,670 | 475,282 | 2,042,851 | 1,643,778 |
| Deposits with banks and other financial institutions | | 1,219,517 | 1,049,259 | 4,217,739 | 3,628,896 |
| Loans and advances to customers | 7 | 4,309,836 | 3,363,654 | 14,905,707 | 11,633,306 |
| Investment securities | 8 | 614,090 | 501,615 | 2,123,850 | 1,734,852 |
| Kuwait Government debt bonds | 9 | 14,651 | 53,262 | 50,671 | 184,208 |
| Investment in associate | 10 | 31,820 | 23,680 | 110,050 | 81,898 |
| Land, premises and equipment | | 89,915 | 78,957 | 310,974 | 273,075 |
| Other assets | 11 | 92,789 | 64,279 | 320,914 | 222,311 |
| Total assets | | 7,898,254 | 6,200,322 | 27,316,366 | 21,444,013 |
| Liabilities | | | | | |
| Due to banks and other financial institutions | | 2,301,937 | 1,322,308 | 7,961,323 | 4,573,245 |
| Customer deposits | | 4,378,486 | 3,956,523 | 15,143,135 | 13,683,762 |
| Certificates of deposit issued | | - | 9,638 | - | 33,333 |
| Other liabilities | 12 | 151,909 | 136,91 | 525,382 | 473,508 |
| Total liabilities | | 6,832,332 | 5,425,379 | 23,629,840 | 18,763,848 |
| Equity | | | | | |
| Equity attributable to shareholders of the parent Bank | | | | | |
| Share capital | 13 | 195,035 | 162,529 | 674,535 | 562,112 |
| Proposed bonus shares | 14 | 9,751 | 16,253 | 33,724 | 56,212 |
| Statutory reserve | 13 | 97,517 | 81,265 | 337,266 | 281,058 |
| Share premium account | 13 | 200,390 | 37,862 | 693,055 | 130,947 |
| Treasury shares | 13 | (23,852) | (17,595) | (82,493) | (60,853) |
| General reserve | | 115,766 | 115,188 | 400,381 | 398,381 |
| Retained earnings | | 307,462 | 225,202 | 1,063,367 | 778,868 |
| Cumulative changes in fair values | 13 | 12,264 | 35,923 | 42,415 | 124,241 |
| Share based payment reserve | 15 | 432 | - | 1,494 | - |
| Total share capital and reserves | | 914,765 | 656,627 | 3,163,744 | 2,270,966 |
| Proposed cash dividend | 14 | 144,972 | 112,853 | 501,391 | 390,305 |
| | | 1,059,737 | 769,480 | 3,665,135 | 2,661,271 |
| Minority interests | | 6,185 | 5,463 | 21,391 | 18,894 |
| Total equity | | 1,065,922 | 774,943 | 3,686,526 | 2,680,165 |
| Total liabilities and equity | | 7,898,254 | 6,200,322 | 27,316,366 | 21,444,013 |

Mohammed Abdul Rahman Al-Bahar
Chairman

Nasser Musaed Abdullah Al-Sayer
Vice Chairman

Ibrahim Shucri Dabdoub
Chief Executive Officer

The attached notes 1 to 29 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

For the year ended 31 December 2006

| | Note | 2006 KD 000's | 2005 KD 000's | 2006 USD 000's | 2005 USD 000's |
|---|------|------------------|------------------|-------------------|-------------------|
| Operating activities | | | | | |
| Net profit for the year | | 253,807 | 205,902 | 877,800 | 712,119 |
| Adjustments : | | | | | |
| Dividend income | | (2,292) | (1,766) | (7,927) | (6,108) |
| Net gains from investment securities | | (24,725) | (10,828) | (85,512) | (37,449) |
| Share of profit of associate | | (2,411) | (1,457) | (8,339) | (5,039) |
| Depreciation | | 3,741 | 2,916 | 12,938 | 10,085 |
| Provision for credit losses | | 30,830 | 23,673 | 106,627 | 81,874 |
| Translation adjustment | | 595 | (2,252) | 2,058 | (7,789) |
| Share based payment reserve | | 496 | - | 1,715 | - |
| Operating profit before changes in operating assets and liabilities | | 260,041 | 216,188 | 899,360 | 747,693 |
| Changes in operating assets and liabilities: | | | | | |
| Central Bank of Kuwait bonds | | (79,448) | (9,900) | (274,773) | (34,239) |
| Kuwait Government treasury bills | | - | 330,693 | - | 1,143,712 |
| Kuwait Government treasury bonds | | (115,388) | (232,166) | (399,073) | (802,954) |
| Deposits with banks and other financial institutions | | (170,258) | (299,037) | (588,843) | (1,034,229) |
| Loans and advances to customers | | (973,208) | (642,279) | (3,365,871) | (2,221,343) |
| Kuwait Government debt bonds | | 38,611 | 44,511 | 133,537 | 153,943 |
| Other assets | | (28,510) | 32,115 | (98,603) | 111,071 |
| Due to banks and other financial institutions | | 979,629 | (75,132) | 3,388,078 | (259,846) |
| Customer deposits | | 421,963 | 711,883 | 1,459,373 | 2,462,070 |
| Certificates of deposit issued | | (9,638) | (11,138) | (33,333) | (38,521) |
| Other liabilities | | 11,496 | 19,022 | 39,759 | 65,788 |
| Net cash from operating activities | | 335,290 | 84,760 | 1,159,611 | 293,145 |
| Investing activities | | | | | |
| Purchase of investment securities | | (426,469) | (125,311) | (1,474,957) | (433,392) |
| Sale/redemption of investment securities | | 315,060 | 507,607 | 1,089,645 | 1,755,575 |
| Dividend income | | 2,292 | 1,766 | 7,927 | 6,108 |
| Proceeds from sale of land, premises and equipment | | 734 | 196 | 2,539 | 678 |
| Acquisition of land, premises and equipment | | (15,433) | (41,127) | (53,376) | (142,239) |
| Investment in associate | | (5,961) | (5,985) | (20,616) | (20,699) |
| Net cash (used in) from investing activities | | (129,777) | 337,146 | (448,838) | 1,166,031 |
| Financing activities | | | | | |
| Redemption of floating rate bonds issued | | - | (133,088) | - | (460,289) |
| Proceeds from issuance of rights shares | | 178,781 | - | 618,320 | - |
| Dividends paid | | (112,853) | (92,713) | (390,306) | (320,651) |
| Sale of treasury shares | | - | 7,285 | - | 25,195 |
| Purchase of treasury shares | | (6,257) | (14,616) | (21,640) | (50,550) |
| Net cash from (used in) financing activities | | 59,671 | (233,132) | 206,374 | (806,295) |
| Increase in cash and short term funds | | 265,184 | 188,774 | 917,147 | 652,881 |
| Cash and short term funds at the beginning of the year | | 580,434 | 391,660 | 2,007,450 | 1,354,569 |
| Cash and short term funds at the end of the year | 6 | 845,618 | 580,434 | 2,924,597 | 2,007,450 |

The attached notes 1 to 29 form part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

For the year ended 31 December 2006

| | Equity attributable to shareholders of the parent Bank | | | | | | | | | | KD 000's | | |
|--|--|-----------------------|-------------------|-----------------------|-----------------|-----------------|-------------------|------------------------|-----------------------------------|-----------------------------|------------------|--------------------|------------------|
| | Share capital | Proposed bonus shares | Statutory reserve | Share premium account | Treasury shares | General reserve | Retained earnings | Proposed cash dividend | Cumulative changes in fair values | Share based payment reserve | Total | Minority interests | Total |
| At 31 December 2004 | 154,790 | 7,739 | 77,395 | 37,862 | (10,431) | 117,396 | 153,033 | 92,413 | 23,866 | - | 654,063 | 1,827 | 655,890 |
| Transfer to statutory reserve | - | - | 3,870 | - | - | - | (3,870) | - | - | - | - | - | - |
| Issue of bonus shares | 7,739 | (7,739) | - | - | - | - | - | - | - | - | - | - | - |
| Dividends paid on treasury shares sold | - | - | - | - | - | - | (300) | 300 | - | - | - | - | - |
| Sale of treasury shares | - | - | - | - | 7,452 | - | (167) | - | - | - | 7,285 | - | 7,285 |
| Purchase of treasury shares | - | - | - | - | (14,616) | - | - | - | - | - | (14,616) | - | (14,616) |
| Dividends paid | - | - | - | - | - | - | - | (92,713) | - | - | (92,713) | - | (92,713) |
| Net profit for the year | - | - | - | - | - | - | 205,612 | - | - | - | 205,612 | 290 | 205,902 |
| Proposed bonus shares | - | 16,253 | - | - | - | - | (16,253) | - | - | - | - | - | - |
| Proposed cash dividend 70 fils per share | - | - | - | - | - | - | (112,853) | 112,853 | - | - | - | - | - |
| Net fair value reserve movement | - | - | - | - | - | - | - | - | 12,057 | - | 12,057 | - | 12,057 |
| Translation adjustment | - | - | - | - | - | (2,208) | - | - | - | - | (2,208) | (44) | (2,252) |
| Acquired/incorporated subsidiaries | - | - | - | - | - | - | - | - | - | - | - | 3,390 | 3,390 |
| At 31 December 2005 | 162,529 | 16,253 | 81,265 | 37,862 | (17,595) | 115,188 | 225,202 | 112,853 | 35,923 | - | 769,480 | 5,463 | 774,943 |
| At 31 December 2005 | 162,529 | 16,253 | 81,265 | 37,862 | (17,595) | 115,188 | 225,202 | 112,853 | 35,923 | - | 769,480 | 5,463 | 774,943 |
| Transfer to statutory reserve | - | - | 16,252 | - | - | - | (16,252) | - | - | - | - | - | - |
| Issue of bonus shares | 16,253 | (16,253) | - | - | - | - | - | - | - | - | - | - | - |
| Issue of rights shares | 16,253 | - | - | 162,528 | - | - | - | - | - | - | 178,781 | - | 178,781 |
| Purchase of treasury shares | - | - | - | - | (6,257) | - | - | - | - | - | (6,257) | - | (6,257) |
| Dividends paid | - | - | - | - | - | - | - | (112,853) | - | - | (112,853) | - | (112,853) |
| Net profit for the year | - | - | - | - | - | - | 253,235 | - | - | - | 253,235 | 572 | 253,807 |
| Proposed bonus shares | - | 9,751 | - | - | - | - | (9,751) | - | - | - | - | - | - |
| Proposed cash dividend 75 fils per share | - | - | - | - | - | - | (144,972) | 144,972 | - | - | - | - | - |
| Net fair value reserve movement | - | - | - | - | - | - | - | - | (23,659) | - | (23,659) | (431) | (24,090) |
| Translation adjustment | - | - | - | - | - | 578 | - | - | - | - | 578 | 17 | 595 |
| Share based payment (Note 15) | - | - | - | - | - | - | - | - | - | 432 | 432 | 64 | 496 |
| Acquired/incorporated subsidiaries | - | - | - | - | - | - | - | - | - | - | - | 500 | 500 |
| At 31 December 2006 | 195,035 | 9,751 | 97,517 | 200,390 | (23,852) | 115,766 | 307,462 | 144,972 | 12,264 | 432 | 1,059,737 | 6,185 | 1,065,922 |

The attached notes 1 to 29 form part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

31 December 2006

1 INCORPORATION AND REGISTRATION

The consolidated financial statements of National Bank of Kuwait S.A.K. (“the Bank”) and its subsidiaries (collectively “the Group”) for the year ended 31 December 2006 were authorised for issue in accordance with a resolution of the directors on 7 January 2007. The Bank is a public shareholding company incorporated in Kuwait in 1952 and is registered as a bank with the Central Bank of Kuwait. The Bank’s head office is at Abdullah Al Ahmed Street, PO Box 95 Safat, 13001 Kuwait.

2 SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

The consolidated financial statements have been prepared in accordance with the regulations of the State of Kuwait for financial services institutions regulated by the Central Bank of Kuwait. These regulations require adoption of all International Financial Reporting Standards (IFRS) except for the IAS 39 requirement for a 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.

The consolidated financial statements comprise the financial statements of National Bank of Kuwait S.A.K. and its subsidiaries as at 31 December each year.

The consolidated financial statements are prepared under the historical cost convention except for the measurement at fair value of derivatives and investment securities other than held to maturity investments. In addition and as more fully described below, assets and liabilities that are hedged in fair value hedging relationships are carried at fair value to the extent of the risk being hedged.

The consolidated financial statements have been presented in Kuwaiti Dinars (thousands) which is the functional currency of the Bank.

The accounting policies are consistent with those used in the previous year, with the exception of the newly adopted policy related to the employee share based payment scheme noted below.

2.2 Basis of consolidation

The consolidated financial statements comprise the financial statements of National Bank of Kuwait S.A.K. and its subsidiaries. The financial statements of subsidiaries and associates are prepared using consistent accounting policies. All intercompany balances and transactions, including unrealised profits arising from intra-group transactions have been eliminated in full.

Subsidiaries

Subsidiaries are all entities over which the Bank has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are unconsolidated from the date that control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries by the Bank. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Bank’s share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference (negative goodwill) is recognised directly in the statement of income.

Associates

Associates are all entities over which the Bank has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investment in an associate is initially recognised at cost and subsequently accounted for by the equity method of accounting. The Bank’s investment in associates includes goodwill identified on acquisition. The Bank’s share of its associate’s post-acquisition profits or losses is recognised in the statement of income, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.

2.3 Foreign currencies

The consolidated financial statements of the Bank are presented in Kuwaiti Dinars which is the Bank's functional currency and presentation currency.

a. Translation of foreign currency transactions

Transactions in foreign currencies are initially recorded in the functional currency rate of exchange ruling at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated into Kuwaiti Dinars at rates of exchange prevailing at the balance sheet date. Any gains or losses are taken to the statement of income.

Translation gains or losses on non-monetary items carried at fair value are included in equity as part of the fair value adjustment on securities available-for-sale, unless the non-monetary item is part of an effective hedging strategy.

b. Translation of financial statements of foreign entities

The results and financial position of all the group entities that have a functional currency different from the presentation currency is translated to presentation currency as follows:

The assets and liabilities are translated at rates of exchange ruling at the balance sheet date. Income and expense items are translated at average exchange rates for the period. Any exchange differences (including those on transactions which hedge such investments) are taken directly to a foreign currency translation adjustment reserve which is part of General Reserve.

2.4 Revenue recognition

Interest income and fees which are considered an integral part of the effective yield of a financial asset, are recognised using the effective yield method, unless collectibility is in doubt. The recognition of interest income is suspended when loans become impaired, such as when overdue by more than 90 days. Other fees receivable are recognised as the services are provided. Dividend income is recognised when the right to receive payment is established.

2.5 Taxation

Taxation is provided for in accordance with the fiscal regulations of the respective countries in which the Group operates.

2.6 Cash and short term funds

Cash and short term funds consist of cash in hand and on current account with other banks together with money at call and deposits with banks and other financial institutions maturing within seven days.

2.7 Central Bank of Kuwait bonds

Central Bank of Kuwait bonds are initially recognised at cost. Premiums and discounts are amortised on a systematic basis to their maturity. These Central Bank of Kuwait bonds are considered as liquid assets.

2.8 Kuwait Government treasury bonds

Kuwait Government treasury bonds are initially recognised at cost. Premiums and discounts are amortised on a systematic basis to their maturity. These treasury bonds are issued by the Central Bank of Kuwait on behalf of the Ministry of Finance and are considered as liquid assets in accordance with the instructions of the Central Bank of Kuwait.

2.9 Deposits with banks and other financial institutions

Deposits with banks and other financial institutions are stated at cost less any amounts written off and provision for impairment. The carrying value of such assets which are being effectively hedged for changes in fair value are adjusted to the extent of the changes in fair value being hedged.

2.10 Loans and advances to customers

Loans and advances are stated at cost less any amounts written off, and net of suspended interest and provision for impairment. The carrying value of such assets which are being effectively hedged for changes in fair value are adjusted to the extent of the changes in fair value being hedged.

Notes to the Consolidated Financial Statements

31 December 2006

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.11 Investment securities

These are classified as follows:

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

All investments with the exception of investments at fair value through statement of income, are initially recognised at cost, being the fair value of the consideration given including directly attributable transaction costs.

Premiums and discounts on non-trading investments (excluding those carried at fair value through statement of income) are amortised using the effective yield method and taken to interest income.

Held to maturity

Investments which have fixed or determinable repayment dates which are intended to be held to maturity, are carried at amortised cost, less provision for impairment in value.

Available for sale

After initial recognition, investments which are classified as “available for sale” are normally remeasured at fair value, unless fair value cannot be reliably determined in which case they are measured at cost less impairment. Fair value changes which are not part of an effective hedging relationship, are reported as a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as “cumulative changes in fair values” within equity, is included in the statement of income for the period. In case of a reversal of previously recognised impairment losses for equity investments, such changes will not be recognised in the current statement of income but will be recorded as an increase in the reserve for cumulative changes in fair values.

That portion of any fair value changes relating to an effective hedging relationship is recognised directly in the statement of income.

Investments carried at fair value through statement of income

Investments are classified as fair value through statement of income if the fair value of the investment can be reliably measured and the classification as fair value through statement of income account is as per the documented strategy of the Group. Investments classified as “investments carried at fair value through statement of income” are remeasured at fair value with all changes in fair value being recorded in the statement of income.

2.12 Kuwait Government debt bonds

Kuwait Government debt bonds are stated at cost less provision for impairment in value, if any.

2.13 Land, premises and equipment

Land and premises comprise mainly branches and offices. All premises and equipment are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the statement of income during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

| | |
|----------------------------|----------------------------------|
| Building on leasehold land | term of lease (maximum 20 years) |
| Building on freehold land | 50 years |
| Equipment | 3-7 years |

Residual values and useful lives of assets are reviewed, and adjusted if appropriate, at each balance sheet date. The carrying values of land, premises and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These are included in the statement of income.

2.14 Customer deposits

All customer deposits are carried at cost, less amounts repaid and adjustments for effective fair value hedges.

2.15 Certificates of deposit issued

Certificates of deposit are initially recognised at cost being their issue proceeds less transaction costs. Subsequently, certificates of deposit are stated at amortised cost less amounts repaid.

2.16 Share based compensation

One of the subsidiaries of the bank operates equity settled share based compensation plans. The fair value of the employee services received in exchange for the grant of options or shares are recognised as expenses. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options or shares granted. At each balance sheet date, the entity revises its estimates of the number of options that are expected to become exercisable or shares that will be granted. It recognises the impact of the revision of original estimates, if any, in the statement of income, with a corresponding adjustment to equity. The proceeds received net of any directly attributable transaction costs are credited to share capital.

2.17 Treasury shares

The Bank's holding of its own shares are accounted for as treasury shares and are stated at cost. When the treasury shares are sold, gains are credited to a separate account in shareholders' equity (treasury shares reserve) which is non distributable. Any realised losses are charged to the same account to the extent of the credit balance on that account. Any excess losses are charged to retained earnings then reserves. Gains realised subsequently on the sale of treasury shares are first used to offset any previously recorded losses in the order of reserves, retained earnings and the treasury shares reserve amount. No cash dividends are distributed on these shares. The issue of bonus shares increases the number of shares proportionately and reduces the average cost per share without affecting the total cost of treasury shares.

2.18 Fair values

For investments and derivatives quoted in an active market, fair value is determined by reference to quoted market prices. Bid prices are used for assets and offer prices are used for liabilities. The fair value of investments in mutual funds, unit trusts, or similar investment vehicles are based on the last published bid price.

For financial instruments where there is no active market, fair value is normally based on one of the following:

- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics
- brokers' quotes
- recent transactions
- option pricing models

The estimated fair value of deposits with no stated maturity, including non-interest bearing deposits, is the amount payable on demand.

2.19 Repurchase and resale agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date at an agreed price (repos) are not derecognised in the balance sheet. Amounts received under these agreements are treated as interest bearing liabilities and the difference between the sale and repurchase price treated as interest expense using the effective yield method.

Assets purchased with a corresponding commitment to resell at a specified future date at an agreed price (reverse repos) are not recognised in the balance sheet. Amounts paid under these agreements are treated as interest earning assets and the difference between the purchase and resale price treated as interest income using the effective yield method.

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2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.20 Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

2.21 Impairment of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, any impairment loss is recognised in the statement of income.

Impairment is determined as follows:

- for assets carried at amortised cost, impairment is based on estimated cash flows discounted at the original effective interest rate
- for assets carried at fair value, impairment is the difference between cost and fair value
- for assets carried at cost, impairment is the difference between actual cost and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset

For available for sale equity investments reversals of impairment losses are recorded as increases in the cumulative changes in fair values reserve.

In addition, in accordance with Central Bank of Kuwait instructions, a minimum general provision of 2% is made on all applicable credit facilities (net of certain categories of collateral) that are not provided for specifically.

2.22 Derecognition of financial assets

A financial asset (or where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired, or
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement, or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

2.23 Derivative instruments

The Group enters into derivative instrument transactions including futures, forwards, swaps and options in the foreign exchange and capital markets. Derivatives are stated at fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models.

For the purposes of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (b) cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction.

In relation to fair value hedges which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument is recognised immediately in the statement of income. The hedged items are adjusted for fair value changes relating to the risk being hedged and the difference is recognised in the statement of income.

Where the adjustment relates to a hedged interest-bearing financial instrument, the adjustment is amortised to the statement of income on a systematic basis such that it is fully amortised by maturity.

In relation to cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised initially in equity and any ineffective portion is recognised in the statement of income. The gains or losses on cash flow hedges recognised initially in equity are transferred to the statement of income in the period in which the hedged transaction impacts the statement of income. Where the hedged transaction results in the recognition of an asset or liability the associated gains or losses that had initially been recognised in equity are included in the initial measurement of the cost of the related asset or liability.

For hedges that do not qualify for hedge accounting, any gains or losses arising from changes in fair value of the hedging instrument are taken directly to the statement of income.

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 Group. For cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the forecasted transaction occurs. In the case of fair value hedges of interest-bearing financial instruments, any adjustment relating to the hedge is amortised over the remaining term to maturity. Where 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.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through the statement of income. These embedded derivatives are measured at fair value with the changes in fair value recognised in the statement of income.

2.24 Trade and settlement date accounting

All “regular way” purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

2.25 Fiduciary assets

Assets and related deposits held in trust or in a fiduciary capacity are not treated as assets or liabilities of the Group and accordingly are not included in these consolidated financial statements.

2.26 Significant accounting judgements and estimation uncertainty

Accounting judgements

In the process of applying the Group’s accounting policies, management has made judgements, (apart from those involving estimations) which have a significant effect in the amounts recognised in the consolidated financial statements. These include the following:

Classification of investments

Management has to decide on acquisition of an investment whether it should be classified as held to maturity, available for sale or investments carried at fair value through statement of income.

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

The Group classifies investments as carried at fair value through statement of income if they are acquired primarily for the purpose of short term profit making.

All other investments are classified as available for sale.

Impairment of investments

The Group treats available for sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost. The determination of what is “significant” or “prolonged” requires significant judgement. In addition, the Group also evaluates among other factors, normal volatility in the share price for quoted investments and the future cash flows and the discount factors for unquoted investments.

Notes to the Consolidated Financial Statements

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2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.26 Significant accounting judgements and estimation uncertainty (continued)

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 investments in debt instruments

The Group reviews problem loans and advances and investments in debt instruments on a quarterly 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 investments

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

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

The determination of the cash flows and discount factors for unquoted investments requires significant estimation.

2.27 Basis of translation

The United States dollar amounts in the consolidated statement of income, consolidated balance sheet and consolidated statement of cash flows represent supplementary information and have been translated at a rate of KD 0.289 per USD which represents the mid-market rate at 31 December 2006.

3 GEOGRAPHICAL AND BUSINESS SEGMENTS

Business segments are distinguishable components of the Group that provide products or services subject to risks and returns different from those of other business segments. Geographic segments are engaged in providing products or services within a particular economic environment subject to risks and return different from those of segments operating in other economic environments. Geographic segments are the primary reporting segments.

(a) Primary segment - Geographical

The Group operates in two geographic markets, domestic and international. Kuwait is designated as domestic. These markets form the basis on which the Group reports its primary segmental information.

The geographical analysis of operating income, profit, total assets and total liabilities is based primarily upon the location of the branch or subsidiary responsible for reporting the results. Transactions between segments are conducted at market rates on an arm's length basis.

| | Domestic | | International | | Total | |
|---------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| | 2006 KD 000's | 2005 KD 000's | 2006 KD 000's | 2005 KD 000's | 2006 KD 000's | 2005 KD 000's |
| Operating income | 339,767 | 267,149 | 55,389 | 44,314 | 395,156 | 311,463 |
| Profit for the year | 226,831 | 182,021 | 26,976 | 23,881 | 253,807 | 205,902 |
| Total assets | 5,450,492 | 4,265,734 | 2,447,762 | 1,934,588 | 7,898,254 | 6,200,322 |
| Total liabilities | 4,515,299 | 3,594,998 | 2,317,033 | 1,830,381 | 6,832,332 | 5,425,379 |

(b) Secondary segment - Business

Although the management of the Group is based primarily on geographical segments, it operates in two major business segments; Commercial Banking and Investment Banking & Asset Management. Commercial Banking delivers a variety of products and services to NBK customers which include lending, deposit taking, trade finance, foreign exchange and custody.

Investment Banking provides cross border financial advisory services and other corporate finance services to corporate and institutional clients and Government agencies in Kuwait and the Middle East region. Asset Management offers investment services through a diverse range of investment funds to retail customers and portfolio management to high net worth individuals and institutional clients. These services include the management of a variety of mutual funds, some of which are in association with other professional fund managers.

| | 2006 KD 000's | 2005 KD 000's |
|---|------------------|------------------|
| Operating income | | |
| Commercial Banking | 369,447 | 292,058 |
| Investment Banking and Asset Management | 23,298 | 17,948 |
| Share of profit of associate | 2,411 | 1,457 |
| | 395,156 | 311,463 |

Assets

| | | |
|---|------------------|------------------|
| Commercial Banking | 7,762,568 | 6,111,109 |
| Investment Banking and Asset Management | 103,866 | 65,533 |
| Investment in associate | 31,820 | 23,680 |
| | 7,898,254 | 6,200,322 |

4 INTEREST INCOME

| | 2006 KD 000's | 2005 KD 000's |
|--|------------------|------------------|
| Deposits with banks and other financial institutions | 95,771 | 49,979 |
| Loans and advances to customers | 333,019 | 238,744 |
| Other | 49,372 | 42,369 |
| | 478,162 | 331,092 |

5 INTEREST EXPENSE

| | 2006 KD 000's | 2005 KD 000's |
|---|------------------|------------------|
| Due to banks and other financial institutions | 67,685 | 37,154 |
| Customer deposits | 147,850 | 72,753 |
| Other | 991 | 1,437 |
| | 216,526 | 111,344 |

6 CASH AND SHORT TERM FUNDS

| | 2006 KD 000's | 2005 KD 000's |
|---|------------------|------------------|
| Balances with Central Bank of Kuwait | 190 | 1,768 |
| Cash on hand and on current account with other banks | 93,578 | 88,442 |
| Money at call | 174,013 | 107,740 |
| Deposits with banks and other financial institutions maturing within seven days | 577,837 | 382,484 |
| | 845,618 | 580,434 |

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7 LOANS AND ADVANCES TO CUSTOMERS

| | Middle East KD 000's | North America KD 000's | Europe KD 000's | Asia KD 000's | Other KD 000's | Total KD 000's |
|-----------------------------|-------------------------|---------------------------|--------------------|------------------|-------------------|-------------------|
| 2006 | | | | | | |
| Commercial | 2,836,397 | 39,016 | 130,513 | 32,388 | 15,769 | 3,054,083 |
| Personal | 1,377,867 | 1,217 | 4,211 | 329 | - | 1,383,624 |
| Loans and advances | 4,214,264 | 40,233 | 134,724 | 32,717 | 15,769 | 4,437,707 |
| Provision for credit losses | | | | | | (127,871) |
| | | | | | | 4,309,836 |
| 2005 | | | | | | |
| Commercial | 2,085,302 | 63,848 | 90,394 | 55,847 | 10,285 | 2,305,676 |
| Personal | 1,159,799 | 301 | 4,923 | - | - | 1,165,023 |
| Loans and advances | 3,245,101 | 64,149 | 95,317 | 55,847 | 10,285 | 3,470,699 |
| Provision for credit losses | | | | | | (107,045) |
| | | | | | | 3,363,654 |

Provisions for credit losses on cash facilities are as follows:

| | Specific | | General | | Total | |
|--|------------------|------------------|------------------|------------------|------------------|------------------|
| | 2006 KD 000's | 2005 KD 000's | 2006 KD 000's | 2005 KD 000's | 2006 KD 000's | 2005 KD 000's |
| Balance at beginning of year | 42,290 | 38,982 | 64,755 | 47,436 | 107,045 | 86,418 |
| Amounts written off and foreign exchange movements | (6,190) | (602) | 92 | (466) | (6,098) | (1,068) |
| Adjustments under Law 41/93 | (102) | (1,850) | - | - | (102) | (1,850) |
| Provision in subsidiary acquired | - | - | - | 198 | - | 198 |
| Provided during the year | 8,299 | 5,760 | 18,727 | 17,587 | 27,026 | 23,347 |
| Balance at end of year | 44,297 | 42,290 | 83,574 | 64,755 | 127,871 | 107,045 |

The provision charge for the year on non-cash facilities is KD 3,804 thousand (2005: KD 326 thousand) and is included in the general provision for credit losses KD 22,531 thousand (2005: KD 17,913 thousand). The available provision on non-cash facilities of KD 19,605 thousand (2005: KD 15,801 thousand) is included under other liabilities (Note 12).

The analysis of specific and general provisions set out above is based on the requirements of the Central Bank of Kuwait. According to the Central Bank of Kuwait instructions, a general provision of 2% has been made on all applicable credit facilities (net of certain categories of collateral), that are not provided for specifically.

For further details regarding Law 41/93 refer to note 9.

Non-performing loans and advances and specific provisions are split between facilities granted pre-invasion and post-liberation, as follows:

| | Pre-invasion KD 000's | Post-liberation KD 000's | Total KD 000's |
|--------------------|--------------------------|-----------------------------|-------------------|
| 2006 | | | |
| Loans and advances | 20,030 | 33,314 | 53,344 |
| Provisions | 19,751 | 24,546 | 44,297 |
| 2005 | | | |
| Loans and advances | 20,131 | 27,769 | 47,900 |
| Provisions | 19,851 | 22,439 | 42,290 |

8 INVESTMENT SECURITIES

| | Debt securities KD 000's | Equities KD 000's | Other investments KD 000's | 2006 Total KD 000's | 2005 Total KD 000's |
|---|-----------------------------|----------------------|-------------------------------|------------------------|------------------------|
| Held to maturity | 10,632 | - | - | 10,632 | 21,879 |
| Available for sale | 430,534 | 85,521 | 49,554 | 565,609 | 448,338 |
| Investments carried at fair value through statement of income | - | - | 37,849 | 37,849 | 31,398 |
| Total | 441,166 | 85,521 | 87,403 | 614,090 | 501,615 |

Debt securities include KD 56,322 thousand which are at variable rates of interest and KD 384,844 thousand which are at fixed rates of interest.

9 KUWAIT GOVERNMENT DEBT BONDS

The Central Bank of Kuwait purchased the debts of resident Kuwaiti and GCC customers existing at 1 August 1990, in addition to related interest up to 31 December 1991, on behalf of the Government of Kuwait in accordance with Decree 32/92 and Law 41/93, as amended, in respect of the purchase by the Government of such debts and the procedure for their collection.

The purchase value of these debts was determined in accordance with the Decree and has been settled by the issue of bonds with a value date of 31 December 1991 and maturing over a maximum period of twenty years from the date of issuance. During 2006 there was a net redemption of KD 39 million (2005: KD 45 million). Interest is at a rate fixed semi-annually by the Central Bank of Kuwait, and is payable semi-annually in arrears. The average rate of interest paid by the Central Bank of Kuwait for 2006 was 4.08 % (2005: 2.64 %).

Under the terms of the purchase agreement with the Central Bank of Kuwait, the amount of the bonds will be adjusted in respect of any difference arising, once the balances of the related debts have been agreed with the customers concerned. The Group therefore, has a contingent liability in this regard.

10 INVESTMENT IN ASSOCIATE

Investment in associate represents the Bank's investment in 20% (2005: 20%) of the equity of International Bank of Qatar Q.S.C. (formerly Grindlays Bank Qatar Q.S.C.).

| | 2006 KD 000's | 2005 KD 000's |
|----------------------------------|------------------|------------------|
| Balance as at 1 January | 23,680 | 16,435 |
| Share of profits | 2,411 | 1,457 |
| Rights issue | 5,961 | 6,020 |
| Foreign exchange difference | (232) | (197) |
| Dividends | - | (35) |
| Balance as at 31 December | 31,820 | 23,680 |

The carrying value of goodwill paid on acquisition of the associate amounts to KD 10.3 million. During the year no impairment loss was recognised and the fair value is not significantly different from the carrying value.

Summarised financial information of the associate is as follows:

| | 2006 KD 000's | 2005 KD 000's |
|-------------|------------------|------------------|
| Assets | 532,339 | 374,056 |
| Liabilities | 423,598 | 301,631 |
| Revenue | 18,578 | 10,342 |
| Net profit | 12,055 | 7,285 |

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11 OTHER ASSETS

| | 2006 KD 000's | 2005 KD 000's |
|--------------------------------|------------------|------------------|
| Interest receivable | 74,344 | 48,669 |
| Sundry debtors and prepayments | 9,908 | 7,816 |
| Other | 8,537 | 7,794 |
| | 92,789 | 64,279 |

12 OTHER LIABILITIES

| | 2006 KD 000's | 2005 KD 000's |
|--|------------------|------------------|
| Interest payable | 45,561 | 19,655 |
| Interest received in advance | 18,151 | 15,636 |
| Taxation and contribution to KFAS | 11,928 | 11,179 |
| General provision on non-cash facilities | 19,605 | 15,801 |
| Accrued expenses | 17,971 | 11,956 |
| Other | 38,693 | 62,683 |
| | 151,909 | 136,910 |

13 SHARE CAPITAL AND RESERVES

a) Share capital

| | 2006 KD 000's | 2005 KD 000's |
|--|------------------|------------------|
| Authorised, issued and fully paid: 1,950,345,966 (2005 : 1,625,288,306) shares of KD 0.100 each | 195,035 | 162,529 |

The movement in ordinary shares in issue during the year was as follows:

| | 2006 | 2005 |
|---------------------------------------|----------------------|----------------------|
| Number of shares in issue 1 January | 1,625,288,306 | 1,547,893,625 |
| Bonus issue | 162,528,830 | 77,394,681 |
| Rights issue | 162,528,830 | - |
| Number of shares in issue 31 December | 1,950,345,966 | 1,625,288,306 |

b) Statutory reserve

The Board of Directors recommended a transfer of KD 16,252 thousand to the statutory reserve. This is in compliance with the Bank's Articles of Association and the Law of Commercial Companies which require a minimum of 10% of profit to be transferred to a non - distributable statutory reserve until such time as this reserve equals 50% of the Bank's issued capital.

Distribution of this reserve is limited to the amount required to enable payment of a dividend of 5% of share capital in years when accumulated profits are not sufficient for the payment of a dividend of that amount.

c) Share premium account

In November 2006, the Bank made a rights issue to its shareholders of KD1.100 per share made up of KD 0.100 share capital and KD 1.000 share premium. A total of 162,528,830 shares were issued resulting in an increase in share capital of KD 16,253 thousand and an increase in the share premium account of KD 162,528 thousand.

The balance in the share premium account is not available for distribution.

d) Treasury shares

At 31 December 2006, the Bank held 17,391,888 treasury shares (2005: 13,106,262) representing 0.89% (2005: 0.81 %) of the issued share capital of the Bank as at that date. The cost and market value of the treasury shares at 31 December 2006 was KD 23,852 thousand and KD 37,914 thousand respectively (2005: KD 17,595 thousand and KD 28,834 thousand respectively). A part of the Bank's reserves that is proportionate to the treasury share holding is not available for distribution.

e) Cumulative changes in fair value

The cumulative changes in fair values reserve is analysed as follows:

| | Cash flow hedges KD 000's | Available for sale portfolio KD 000's | Total KD 000's |
|------------------------------------|---------------------------------|---|-------------------|
| Balance at 31 December 2005 | - | 35,923 | 35,923 |
| Net unrealised losses | - | (5,046) | (5,046) |
| Net realised gains | - | (18,613) | (18,613) |
| Balance at 31 December 2006 | - | 12,264 | 12,264 |
| Balance at 31 December 2004 | (61) | 23,927 | 23,866 |
| Net unrealised gains | - | 13,190 | 13,190 |
| Net realised losses (gains) | 61 | (1,194) | (1,133) |
| Balance at 31 December 2005 | - | 35,923 | 35,923 |

14 PROPOSED DIVIDEND

The board of directors recommended distribution of a cash dividend of 75 fils per share (2005: 70 fils per share) and bonus shares of 5% (2005: 10%) on outstanding shares as at 31 December 2006. The proposed dividend, if approved, shall be payable to the shareholders registered in the Bank's records as of the date of the general assembly meeting.

15 SHARE BASED PAYMENT RESERVE

One of the subsidiaries of the Bank operates a restricted employee stock option plan and a restricted share grant plan for eligible employees. The plans are equity settled and there are no cash settlement alternatives. The charge for the year for share based payment plans amounting to KD 496 thousand has been included under staff expenses in the statement of income, with a corresponding credit to share based payment reserve under equity.

The share based payment plans are not material to the Group, accordingly full disclosures of the plans have not been made in the consolidated financial statements.

16 SUBSIDIARY COMPANIES

Principal operating subsidiaries:

| Name of company and country of incorporation | Principal business | % Capital held |
|--|-----------------------|----------------|
| National Bank of Kuwait (International) plc - United Kingdom | Banking | 100.0 |
| NBK Investment Management Limited - United Kingdom | Investment management | 60.0 |
| NBK Banque Privee (Suisse) S.A. - Switzerland | Investment management | 100.0 |
| National Bank of Kuwait (Lebanon) S.A.L. - Lebanon | Banking | 85.5 |
| National Investors Group Holdings Limited - Cayman Islands | Investment management | 100.0 |
| Credit Bank of Iraq. S.A. - Iraq | Banking | 75.0 |
| Watani Investment Company K.S.C.(Closed) - Kuwait | Investment company | 87.1 |

At 31 December 2006, 38.14% (2005: 38.14%) of the Group's interest in National Bank of Kuwait (Lebanon) S.A.L. was held by an intermediate holding company, NBK Holding (Liban) S.A.L.

The Bank also holds voting capital in certain special purpose companies, which have been established to manage funds and fiduciary assets on behalf of the Bank's customers. The Bank does not have a beneficial interest in the underlying assets of these companies.

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17 COMMITMENTS AND CONTINGENT LIABILITIES

| | 2006 KD 000's | 2005 KD 000's |
|--|------------------|------------------|
| Commitments on behalf of customers for which there are corresponding liabilities by the customers concerned: | | |
| Acceptances | 69,395 | 90,753 |
| Letters of credit | 412,863 | 324,216 |
| Guarantees | 1,030,863 | 808,945 |
| Irrevocable commitments to extend credit | 1,186,733 | 671,770 |
| | 2,699,854 | 1,895,684 |

In the normal course of business the Group has exposure to various indirect credit commitments which, though not reflected in the balance sheet, are subject to normal credit standards, financial controls and monitoring procedures.

These credit commitments do not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded. Credit losses, if any, which may result from exposure to such commitments are not expected to be significant.

18 DERIVATIVE INSTRUMENTS

The Group deals in interest rate and foreign exchange derivatives to earn fees, generate trading revenues and manage its asset and liability exposures.

Notional principal amounts merely represent amounts to which a rate or price is applied to determine the amounts of cash flows to be exchanged and do not represent the potential gain or loss associated with the market or credit risk of such instruments.

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Group.

Exchange-traded contracts are subject to daily margin requirements and are therefore deemed to have no additional credit risk.

| | Up to 3 months KD 000's | 3 to 12 months KD 000's | Over 1 year KD 000's | Total KD 000's |
|---------------------------|-------------------------------|-------------------------------|----------------------------|-------------------|
| 2006 | | | | |
| Notional principal | | | | |
| Forward rate agreements | - | 8,618 | 7,872 | 16,490 |
| Structured notes | 622 | 10,687 | 55,717 | 67,026 |
| Interest rate swaps | 618,727 | 125,159 | 9,922 | 753,808 |
| Forward foreign exchange | 621,998 | 192,695 | 44,360 | 859,053 |
| | 1,241,347 | 337,159 | 117,871 | 1,696,377 |
| 2005 | | | | |
| Notional principal | | | | |
| Financial futures | 936 | - | - | 936 |
| Forward rate agreements | 15,279 | 33,665 | 15,739 | 64,683 |
| Interest rate swaps | 305,651 | 81,550 | 50,592 | 437,793 |
| Forward foreign exchange | 1,063,900 | 124,529 | 11,122 | 1,199,551 |
| | 1,385,766 | 239,744 | 77,453 | 1,702,963 |

The fair value (equivalent to market value) of derivative instruments included in the financial records as at 31 December is summarised as follows, and predominantly reflects forward foreign exchange and interest rate swap contracts:

Derivative instruments held as:

| | Net positive (negative) Fair value KD 000's | Description of hedged items |
|---|--|-----------------------------|
| 2006 | | |
| Trading (and non-qualifying hedges) | 15 | |
| Fair value hedges (interest rate swaps) | 4,903 | Fixed rate bonds and loans |
| | 4,918 | |
| 2005 | | |
| Trading (and non-qualifying hedges) | (73) | |
| Fair value hedges (interest rate swaps) | (2,667) | Fixed rate bonds and loans |
| | (2,740) | |

19 RELATED PARTY TRANSACTIONS

Certain related parties (shareholders, directors and officers of the Bank, companies which they control or over which they exert significant influence, and entities associated with the Group) were customers of the Bank and its subsidiaries in the ordinary course of business. Such transactions were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with unrelated parties and did not involve more than a normal amount of risk.

In accordance with Central Bank of Kuwait regulations regarding lending to Board Members and their related parties such lending is secured by tangible collateral.

Details of the interests of Board Members and Executive Officers are as follows:

| | Number of Board Members or Executive Officers | | Number of related parties | | 2006 KD 000's | 2005 KD 000's |
|---------------------------|---|------|------------------------------|------|------------------|------------------|
| | 2006 | 2005 | 2006 | 2005 | | |
| Board Members | | | | | | |
| Loans (secured) | 6 | 5 | 21 | 20 | 201,510 | 133,944 |
| Contingent liabilities | 4 | 2 | 19 | 17 | 68,633 | 73,402 |
| Credit cards | 5 | 7 | 3 | 1 | 26 | 42 |
| Deposits | 8 | 8 | 15 | 18 | 31,664 | 43,018 |
| Collateral against loans | 6 | 5 | 21 | 20 | 444,078 | 433,202 |
| Interest and fee income | | | | | 14,121 | 9,002 |
| Interest expense | | | | | 956 | 527 |
| Executive Officers | | | | | | |
| Loans | 7 | 7 | - | - | 361 | 438 |
| Contingent liabilities | 4 | 2 | - | - | 8 | 3 |
| Credit cards | 7 | 8 | - | - | 19 | 10 |
| Deposits | 15 | 9 | - | - | 948 | 440 |
| Interest and fee income | | | | | 5 | 14 |
| Interest expense | | | | | 1 | 8 |

There are no material transactions or balances with the associate.

Notes to the Consolidated Financial Statements

31 December 2006

20 KEY MANAGEMENT COMPENSATION

Details of compensation for key management, including Executive Officers, comprise the following:

| | 2006 KD 000's | 2005 KD 000's |
|--|------------------|------------------|
| Salaries and other short term benefits | 3,692 | 2,457 |
| Post-employment benefits | 910 | 711 |
| | 4,602 | 3,168 |

21 EARNINGS PER SHARE

The basic and diluted earnings per share is calculated by dividing the profit for the year by the weighted average number of shares outstanding during the year as follows:

| | 2006 KD 000's | 2005 KD 000's |
|---|------------------|------------------|
| Net profit attributable to shareholders of the parent Bank | 253,235 | 205,612 |
| Weighted average number of shares outstanding during the year (thousands) | 1,862,524 | 1,853,416 |
| Earnings per share | 136 Fils | 111 Fils |

Earnings per share calculations for 2005 have been adjusted to take account of the bonus shares and rights shares issued in 2006.

22 FAIR VALUE OF FINANCIAL INSTRUMENTS

In the opinion of management, with the exception of Kuwait Government Debt Bonds, the carrying values of all other financial instruments are not significantly different from fair values.

It is not practicable to determine the fair value of Kuwait Government Debt Bonds with sufficient accuracy, as the future cash flows are not determinable. Information on the principal characteristics of these bonds is presented in note 9.

23 RISK MANAGEMENT

In accordance with the Central Bank of Kuwait's directives, the Group has implemented a comprehensive system for the measurement and management of risk, including the establishment of an independent unit for this purpose.

23.1 Credit risk

All policies relating to credit are reviewed and approved by the Board of Directors.

Credit limits are established for all customers after a careful assessment of their creditworthiness. Standing procedures, outlined in the Group's Credit Policy Manual, require that all credit proposals be subjected to detailed screening by the domestic or international credit control divisions pending submission to the appropriate credit committee. Whenever necessary, all loans are secured by acceptable forms of collateral to mitigate the related credit risks.

In accordance with the instructions of the Central Bank of Kuwait dated 18 December 1996, setting out the rules and regulations regarding the classification of credit facilities, the Group has formed an internal committee comprising competent professional staff and having as its purpose the study and evaluation of the existing credit facilities of each customer of the Group. This committee is required to identify any abnormal situations and difficulties associated with a customer's position which might cause the debt to be classified as irregular, and to determine an appropriate provisioning level. The committee, which meets regularly throughout the year, also studies the positions of those customers whose irregular balances exceed 25% of their total debt, in order to determine whether further provisions are required.

The Group further limits risk through diversification of its assets by geography and sector. In addition, all credit facilities are continually monitored based on a periodical review of the credit performance and account rating.

EXPOSURE TO CREDIT RISK UNDER FINANCIAL INSTRUMENTS

| | Middle East KD 000's | North America KD 000's | Europe KD 000's | Asia KD 000's | Other KD 000's | Total KD 000's |
|---|----------------------------|------------------------------|--------------------|------------------|-------------------|-------------------|
| 2006 | | | | | | |
| Geographic region | | | | | | |
| Cash and deposits with banks and other financial institutions | 1,254,228 | 164,392 | 542,254 | 92,958 | 11,303 | 2,065,135 |
| Central Bank of Kuwait bonds | 89,348 | - | - | - | - | 89,348 |
| Kuwait Government treasury bonds | 590,670 | - | - | - | - | 590,670 |
| Loans and advances to customers | 4,102,774 | 39,428 | 132,371 | 29,557 | 5,706 | 4,309,836 |
| Investment securities | 215,978 | 212,681 | 93,450 | 78,302 | 13,679 | 614,090 |
| Kuwait Government debt bonds | 14,651 | - | - | - | - | 14,651 |
| Investment in associate | 31,820 | - | - | - | - | 31,820 |
| Other assets | 73,632 | 2,641 | 13,466 | 2,945 | 105 | 92,789 |
| | 6,373,101 | 419,142 | 781,541 | 203,762 | 30,793 | 7,808,339 |
| Commitments and contingent liabilities (Note 17) | 2,068,988 | 59,381 | 282,175 | 277,381 | 11,929 | 2,699,854 |
| | 8,442,089 | 478,523 | 1,063,716 | 481,143 | 42,722 | 10,508,193 |
| Sector | | | | | | |
| Trading and manufacturing | | | | | | 3,171,332 |
| Banks and other financial institutions | | | | | | 3,195,937 |
| Construction and real estate | | | | | | 720,825 |
| Personal | | | | | | 1,336,663 |
| Other | | | | | | 2,083,436 |
| | | | | | | 10,508,193 |

Credit risk exposure in respect of earning assets and off-balance sheet financial items represents the carrying values of assets and contingencies which could be impacted as a result of failures by the Group's counterparties to discharge their obligations under these contracts.

Concentrations of credit risk arise from exposure to customers having similar characteristics in terms of the sector in which they are engaged or the geographical location in which they operate such that their ability to discharge contractual obligations may be similarly affected by changes in political, economic or other conditions. Significant concentrations of the Group's risk assets by region and sector are set out above.

Notes to the Consolidated Financial Statements

31 December 2006

23 RISK MANAGEMENT (continued)

23.1 Credit risk (continued)

EXPOSURE TO CREDIT RISK UNDER FINANCIAL INSTRUMENTS (continued)

| | Middle East KD 000's | North America KD 000's | Europe KD 000's | Asia KD 000's | Other KD 000's | Total KD 000's |
|--|----------------------------|------------------------------|--------------------|------------------|-------------------|-------------------|
| 2005 | | | | | | |
| Geographic region | | | | | | |
| Cash and deposits with banks and other financial institutions | 1,170,259 | 62,011 | 317,806 | 76,692 | 2,925 | 1,629,693 |
| Central Bank of Kuwait bonds | 9,900 | - | - | - | - | 9,900 |
| Kuwait Government treasury bonds | 475,282 | - | - | - | - | 475,282 |
| Loans and advances to customers | 3,159,816 | 62,937 | 93,420 | 46,665 | 816 | 3,363,654 |
| Investment securities | 208,861 | 103,156 | 88,693 | 75,156 | 25,749 | 501,615 |
| Kuwait Government debt bonds | 53,262 | - | - | - | - | 53,262 |
| Investment in associate | 23,680 | - | - | - | - | 23,680 |
| Other assets | 48,745 | 2,165 | 10,749 | 2,553 | 67 | 64,279 |
| | 5,149,805 | 230,269 | 510,668 | 201,066 | 29,557 | 6,121,365 |
| Commitments and contingent liabilities (Note 17) | 1,534,805 | 26,558 | 160,444 | 168,696 | 5,181 | 1,895,684 |
| | 6,684,610 | 256,827 | 671,112 | 369,762 | 34,738 | 8,017,049 |
| Sector | | | | | | |
| Trading and manufacturing | | | | | | 2,268,449 |
| Banks and other financial institutions | | | | | | 2,548,544 |
| Construction and real estate | | | | | | 533,219 |
| Personal | | | | | | 1,130,129 |
| Other | | | | | | 1,536,708 |
| | | | | | | 8,017,049 |

23.2 Foreign exchange risk

Foreign exchange risks are controlled through limits pre-established by the Board of Directors on counterparty and currency position exposures. Assets are typically funded in the same currency as that of the business being transacted to eliminate exchange exposures. Appropriate segregation of duties exists between the front and back office functions while compliance with position limits is independently monitored on an ongoing basis.

Hedging transactions are used to manage risks in other currencies. At 31 December 2006 there were no significant foreign currency exposures.

23.3 Interest rate risk

The Group is not excessively exposed to interest rate risk as its assets and liabilities are repriced relatively frequently and exposures arising on any medium term fixed rate lending or fixed rate borrowing are immediately covered by interest rate swaps. Furthermore, the reverse cumulative interest rate gap is carefully monitored on a daily basis and adjusted where necessary to reflect changing market conditions. Maturities of assets and liabilities have been determined on the basis of contractual pricing or maturity dates, whichever is earlier.

The off-balance sheet gap represents the net notional amounts of off-balance sheet financial items such as forward rate agreements and interest rate swaps which are used to manage interest rate risk.

A proportion of Customer deposits consists of non-interest bearing current and trust accounts.

INTEREST RATE SENSITIVITY

| | Up to 3 months KD 000's | 3 to 12 months KD 000's | Over 1 year KD 000's | Non-interest sensitive KD 000's | Total KD 000's | Effective interest rate % |
|---|-------------------------------|-------------------------------|----------------------------|---------------------------------------|-------------------|------------------------------------|
| 2006 | | | | | | |
| Assets | | | | | | |
| Cash and deposits with banks and other financial institutions | 1,954,134 | 30,244 | 399 | 80,358 | 2,065,135 | 4-6 |
| Central Bank of Kuwait bonds | 89,348 | - | - | - | 89,348 | 5-6 |
| Kuwait Government treasury bonds | 342,147 | 148,418 | 100,105 | - | 590,670 | 4-5 |
| Loans and advances to customers | 3,263,003 | 450,338 | 596,207 | 288 | 4,309,836 | 7-11 |
| Investment securities | 292,857 | 51,188 | 140,778 | 129,267 | 614,090 | 5-7 |
| Kuwait Government debt bonds | - | 14,651 | - | - | 14,651 | 4 |
| Investment in associate | - | - | - | 31,820 | 31,820 | |
| Land, premises and equipment | - | - | - | 89,915 | 89,915 | |
| Other assets | - | - | - | 92,789 | 92,789 | |
| | 5,941,489 | 694,839 | 837,489 | 424,437 | 7,898,254 | |
| Liabilities and shareholders' equity | | | | | | |
| Due to banks and other financial institutions | 2,053,782 | 241,983 | 1,825 | 4,347 | 2,301,937 | 4-6 |
| Customer deposits | 3,952,716 | 266,564 | 64,278 | 94,928 | 4,378,486 | 0-6 |
| Other liabilities | - | - | - | 151,909 | 151,909 | |
| Proposed cash dividend | - | - | - | 144,972 | 144,972 | |
| Shareholders' equity and minority interests | - | - | - | 920,950 | 920,950 | |
| | 6,006,498 | 508,547 | 66,103 | 1,317,106 | 7,898,254 | |
| On-balance sheet gap | (65,009) | 186,292 | 771,386 | (892,669) | - | |
| Off-balance sheet gap | 114,317 | 53,349 | (167,666) | - | - | |
| Interest rate sensitivity gap | 49,308 | 239,641 | 603,720 | (892,669) | - | |
| Cumulative gap | 49,308 | 288,949 | 892,669 | | | |

Notes to the Consolidated Financial Statements

31 December 2006

23 RISK MANAGEMENT (continued)

23.3 Interest rate risk (continued)

INTEREST RATE SENSITIVITY (continued)

| | Up to 3 months KD 000's | 3 to 12 months KD 000's | Over 1 year KD 000's | Non-interest sensitive KD 000's | Total KD 000's | Effective interest rate % |
|--|-------------------------------|-------------------------------|----------------------------|---------------------------------------|-------------------|------------------------------------|
| 2005 | | | | | | |
| Assets | | | | | | |
| Cash and deposits with banks and other financial institutions | 1,520,666 | 12,939 | 16,746 | 79,342 | 1,629,693 | 3-5 |
| Central Bank of Kuwait bonds | 9,900 | - | - | - | 9,900 | 4-5 |
| Kuwait Government treasury bonds | 161,591 | 313,691 | - | - | 475,282 | 3-4 |
| Loans and advances to customers | 2,601,164 | 420,979 | 341,129 | 382 | 3,363,654 | 6-10 |
| Investment securities | 175,882 | 53,875 | 149,894 | 121,964 | 501,615 | 4-7 |
| Kuwait Government debt bonds | - | 53,262 | - | - | 53,262 | 3 |
| Investment in associate | - | - | - | 23,680 | 23,680 | |
| Land, premises and equipment | - | - | - | 78,957 | 78,957 | |
| Other assets | - | - | - | 64,279 | 64,279 | |
| | 4,469,203 | 854,746 | 507,769 | 368,604 | 6,200,322 | |
| Liabilities and shareholders' equity | | | | | | |
| Due to banks and other financial institutions | 1,265,940 | 47,494 | 5,549 | 3,325 | 1,322,308 | 3-4 |
| Customer deposits | 3,655,981 | 201,469 | 47,613 | 51,460 | 3,956,523 | 0-5 |
| Certificates of deposit issued | 7,594 | 2,044 | - | - | 9,638 | 4 |
| Other liabilities | - | - | - | 136,910 | 136,910 | |
| Proposed cash dividend | - | - | - | 112,853 | 112,853 | |
| Shareholders' equity and minority interests | - | - | - | 662,090 | 662,090 | |
| | 4,929,515 | 251,007 | 53,162 | 966,638 | 6,200,322 | |
| On-balance sheet gap | (460,312) | 603,739 | 454,607 | (598,034) | - | |
| Off-balance sheet gap | 163,819 | (3,551) | (160,268) | - | - | |
| Interest rate sensitivity gap | (296,493) | 600,188 | 294,339 | (598,034) | - | |
| Cumulative gap | (296,493) | 303,695 | 598,034 | | | |

23.4 Liquidity risk

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

The table below summarises the maturity profile of the Group's assets and liabilities based on contractual repayment arrangements and does not take account of the effective maturities as indicated by the Group's deposit retention history.

The maturity profile of the assets and liabilities at 31 December was as follows:

| | Up to 3 months KD 000's | 3 to 12 months KD 000's | Over 1 year KD 000's | Total KD 000's |
|---|-------------------------------|-------------------------------|----------------------------|-------------------|
| 2006 | | | | |
| Assets | | | | |
| Cash and deposits with banks and other financial institutions | 2,032,177 | 32,558 | 400 | 2,065,135 |
| Central Bank of Kuwait bonds | 89,348 | - | - | 89,348 |
| Kuwait Government treasury bonds | 227,466 | 203,205 | 159,999 | 590,670 |
| Loans and advances to customers | 1,899,599 | 627,986 | 1,782,251 | 4,309,836 |
| Investment securities | 232,151 | 59,147 | 322,792 | 614,090 |
| Kuwait Government debt bonds | - | 14,651 | - | 14,651 |
| Investment in associate | - | - | 31,820 | 31,820 |
| Land, premises and equipment | - | - | 89,915 | 89,915 |
| Other assets | 84,250 | 8,190 | 349 | 92,789 |
| | 4,564,991 | 945,737 | 2,387,526 | 7,898,254 |

Liabilities and shareholders' equity

| | | | | |
|---|------------------|----------------|------------------|------------------|
| Due to banks and other financial institutions | 2,058,128 | 241,983 | 1,826 | 2,301,937 |
| Customer deposits | 4,047,643 | 266,564 | 64,279 | 4,378,486 |
| Other liabilities | 128,918 | - | 22,991 | 151,909 |
| Proposed cash dividend | 144,972 | - | - | 144,972 |
| Shareholders' equity and minority interests | - | - | 920,950 | 920,950 |
| | 6,379,661 | 508,547 | 1,010,046 | 7,898,254 |
| Net liquidity gap | (1,814,670) | 437,190 | 1,377,480 | - |

| | Up to 3 months KD 000's | 3 to 12 months KD 000's | Over 1 year KD 000's | Total KD 000's |
|---|-------------------------------|-------------------------------|----------------------------|-------------------|
| 2005 | | | | |
| Assets | | | | |
| Cash and deposits with banks and other financial institutions | 1,588,180 | 31,284 | 10,229 | 1,629,693 |
| Central Bank of Kuwait bonds | 9,900 | - | - | 9,900 |
| Kuwait Government treasury bonds | 161,591 | 313,691 | - | 475,282 |
| Loans and advances to customers | 1,490,897 | 572,749 | 1,300,008 | 3,363,654 |
| Investment securities | 71,068 | 42,325 | 388,222 | 501,615 |
| Kuwait Government debt bonds | - | 53,262 | - | 53,262 |
| Investment in associate | - | - | 23,680 | 23,680 |
| Land, premises and equipment | - | - | 78,957 | 78,957 |
| Other assets | 56,485 | 7,445 | 349 | 64,279 |
| | 3,378,121 | 1,020,756 | 1,801,445 | 6,200,322 |

Liabilities and shareholders' equity

| | | | | |
|---|------------------|----------------|----------------|------------------|
| Due to banks and other financial institutions | 1,235,018 | 81,741 | 5,549 | 1,322,308 |
| Customer deposits | 3,707,644 | 201,266 | 47,613 | 3,956,523 |
| Certificates of deposit issued | 7,594 | 2,044 | - | 9,638 |
| Other liabilities | 113,025 | - | 23,885 | 136,910 |
| Proposed cash dividend | 112,853 | - | - | 112,853 |
| Shareholders' equity and minority interests | - | - | 662,090 | 662,090 |
| | 5,176,134 | 285,051 | 739,137 | 6,200,322 |
| Net liquidity gap | (1,798,013) | 735,705 | 1,062,308 | - |

Notes to the Consolidated Financial Statements

31 December 2006

23 RISK MANAGEMENT (continued)

23.5 Equity price risk

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

23.6 Operational risk

The Group has a set of policies and procedures, which are approved by the Board of Directors and are applied to identify, assess and supervise operational risk in addition to other types of risks relating to the banking and financial activities of the Group. Operational risk is managed by the Operational Risk function, which ensures compliance with policies and procedures and monitors operational risk as part of overall global risk management.

The Operational Risk function of the Group is in line with the Central Bank of Kuwait instructions dated 14 November 1996, concerning the general guidelines for internal controls and the instructions dated 13 October 2003, regarding the sound practices for managing and supervising operational risks in banks.

24 CONCENTRATION OF DEPOSIT LIABILITIES

| | 2006 KD 000's | 2005 KD 000's |
|--------------------------|------------------|------------------|
| Geographic region | | |
| Middle East | 5,760,662 | 4,680,439 |
| North America | 391,179 | 181,715 |
| Europe | 336,795 | 251,454 |
| Asia | 174,757 | 147,465 |
| Other | 17,030 | 17,758 |
| | 6,680,423 | 5,278,831 |

25 MANAGEMENT OF PURCHASED DEBTS

In accordance with Decree 32/92 and Law 41/93 in respect of the financial and banking sector, the Bank is required to manage the purchased debts without remuneration in conformity with the terms of the debt purchase agreement.

26 NUMBER OF STAFF

The number of staff (full time equivalent) employed by the Group at 31 December 2006 was 2,921 (2005: 2,463).

27 BOARD OF DIRECTORS REMUNERATION

The Board of Directors does not receive any emoluments in the form of fees, salaries or bonuses for their services rendered to the Bank.

28 FUNDS UNDER MANAGEMENT

The Group manages a number of funds, some of which are managed in association with other professional fund managers. The funds have no recourse to the general assets of the Group and the Group has no recourse to the assets of the funds. Accordingly the assets of these funds are not included in the consolidated financial statements. As at 31 December 2006, funds under management was KD 2,250 million (2005: KD 1,876 million).

29 BASEL II PILLAR 3 DISCLOSURES

The disclosures relating to the capital adequacy regulations issued by Central Bank of Kuwait as stipulated in Central Bank of Kuwait circular number 2/BS/184/2005 dated 21 December 2005 are included under the 'Risk Management' section of the annual report.

Independent Auditors' Report to the Shareholders of

National Bank of Kuwait S.A.K.

We have audited the accompanying consolidated financial statements of National Bank of Kuwait S.A.K. ("the Bank") and its subsidiaries (collectively "the Group"), which comprise the consolidated balance sheet as of 31 December 2006 and the consolidated statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

Report on Other Legal and Regulatory Requirements

Furthermore, in our opinion proper books of account have been kept by the Bank and the consolidated financial statements, together with the contents of the report of the Bank's Board of Directors relating to these consolidated 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 consolidated financial statements incorporate all information that is required by the Capital Adequacy Regulations issued by the Central Bank of Kuwait as stipulated in CBK Circular number 2/BS/184/2005 dated 21 December 2005, Commercial Companies Law of 1960, as amended, and by the Bank's articles of association, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of Capital Adequacy Regulations issued by the Central Bank of Kuwait as stipulated in CBK Circular number 2/BS/184/2005 dated 21 December 2005, Commercial Companies Law of 1960, as amended, nor of the articles of association have occurred during the year ended 31 December 2006 that might have had a material effect on the business of the Group 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 31 December 2006.

WALEED A. AL OSAIMI
LICENCE NO. 68 A
ERNST & YOUNG
AL AIBAN, AL OSAIMI & PARTNERS

JASSIM AHMAD AL-FAHAD
LICENCE NO. 53 A
DELOITTE
AL-FAHAD & CO.

7 January 2007
Kuwait

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Group General Manager
Consumer Banking
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Shaikha K. Al-Bahar
Group General Manager
Corporate Banking
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George Y. Nasra
CEO
NBK Capital
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Ext: 6906 Fax: 224 6905

Hanafi Hussain
Group General Manager
Credit Control, Operations
& Legal Affairs
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Waleed K. Al-Yaqout
Group General Manager
Administration
Ext: 6620 Fax: 224 6980

Salah Y. Al-Fulajj
Group General Manager
Investment Services &
Treasury
Ext: 6655 Fax: 224 6984

Randa Sadik
Group General Manager
International Branches
and Subsidiaries
Ext: 6969 Fax: 224 6977

Consumer Banking Group

Retail Banking
Ext: 3100 Fax: 246 0160

Domestic Branches
Ext: 2232 Fax: 246 7929

Call Center
Ext: 4950 Fax: 241 7641

Central Cash
Ext: 2128 Fax: 242 9453

Internet
Ext: 3020 Fax: 241 2373

Direct Sales
Ext: 5064 Fax: 224 6987

Consumer Credit & Marketing
Ext: 2188 Fax: 241 9512

Cards Services
Ext: 2517 Fax: 246 0165

Consumer Lending
Ext: 2377 Fax: 224 6865

Marketing
Ext: 3107 Fax: 241 2373

Advertising
Ext: 3068 Fax: 240 9235

Retail Sales
Ext: 3388 Fax: 241 6738

Private Banking
Ext: 3280
Fax: 241 8415 or 224 6619

Corporate Banking Group

Corporate Banking
Ext: 2116 Fax: 246 8032

Trade Finance
Ext: 2161 Fax: 245 8972

Foreign Corporate
Ext: 2307 Fax: 242 6813

Marketing & Business Development
Ext: 2316 Fax: 246 8032

Credit Control, Operations & Legal Affairs Group

Operations
Ext: 3060 Fax: 242 7809

Domestic Credit Control
Ext: 2462 Fax: 246 4162

Legal Affairs
Ext: 3091 Fax: 244 5098

Bad Loans Collection
Ext: 2100 Fax: 241 7625

Risk Management
Ext: 2263 Fax: 246 7926

Investment Services & Treasury

Investment Services
Ext: 6956 Fax: 224 6984

Treasury
Ext: 3355 Fax: 246 7276

International Branches and Subsidiaries Group

Regional Institutional Banking
Ext: 6968 Fax: 224 6977

Please refer to International Network for a complete listing

Administration
Ext: 6650 Fax: 224 3250

Executive Office
Ext: 3222 Fax: 246 2469

Human Resources
Ext: 2615 Fax: 244 3250

Information Technology
Ext: 2400 Fax: 245 9233

Economic Research
Ext: 5353 Fax: 224 6973

Internal Audit & Quality Assurance
Tel: 572 4182 Fax: 571 1785

Financial Control
Ext: 2482 Fax: 242 4069

Public Relations
Ext: 3166 Fax: 246 5190

International Legal Affairs
Ext: 2065 Fax: 243 6208

Local Branches

Head Office

Tel: 242 2011
Fax: 241 6922

Ahmadi

Tel: 801 801
Fax: 398 5643

Ahmed Al-Jaber

Tel: 801 801
Fax: 241 9442

Andalus

Tel: 801 801
Fax: 499 1802

Ardiah

Tel: 801 801
Fax: 488 3927

Bayan

Tel: 801 801
Fax: 538 9382

Burj Al-Tahreer

Tel: 801 801
Fax: 247 3764

Cinema Al Salmiya

Tel: 801 801
Fax: 571 0950

Dahyat Abdullah Al-Salem

Tel: 801 801
Fax: 256 1854

Daiyah

Tel: 801 801
Fax: 256 3820

Dasma

Tel: 801 801
Fax: 252 6485

Doha

Tel: 801 801
Fax: 487 4696

Fahad Al-Salem

Tel: 801 801
Fax: 241 7642

Fahaheel

Tel: 801 801
Fax: 392 4447

Faiha

Tel: 801 801
Fax: 251 6741

Farwaniya

Tel: 801 801
Fax: 474 0013

Fintas

Tel: 801 801
Fax: 390 3552

Ghazali

Tel: 801 801
Fax: 483 4752

Hawalli

Tel: 801 801
Fax: 261 2407

Ibraq Kheitan

Tel: 801 801
Fax: 472 4084

Jabriya

Tel: 801 801
Fax: 531 7742

Jahra

Tel: 801 801
Fax: 455 3121

Jleeb Al-Shuyoukh

Tel: 801 801
Fax: 431 7449

Kaifan

Tel: 801 801
Fax: 483 9016

Manshar

Tel: 801 801
Fax: 224 6856

Ministries Complex

Tel: 801 801
Fax: 245 2721

Mishref

Tel: 801 801
Fax: 538 9832

MTC Headquarters

Tel: 801 801
Fax: 481 3699

Mubarak Al Kabeer

Tel: 801 801
Fax: 481 3699

Nuzha

Tel: 801 801
Fax: 255 0858

Othman

Tel: 801 801
Fax: 265 6425

Qadisiya

Tel: 801 801
Fax: 254 6738

Qurain

Tel: 801 801
Fax: 544 0772

Qurtuba

Tel: 801 801
Fax: 534 4780

Ras-Al Salmiya

Tel: 801 801
Fax: 572 9216

Rawdha

Tel: 801 801
Fax: 252 2358

Riqqa

Tel: 801 801
Fax: 394 4147

Rumaihiya

Tel: 801 801
Fax: 564 0980

Sabah Al-Nasser

Tel: 801 801
Fax: 480 7577

Sabah Al-Salem

Tel: 801 801
Fax: 551 7215

Sabahiya

Tel: 801 801
Fax: 361 7013

Sabhan

Tel: 801 801
Fax: 474 0074

Salmiya

Tel: 801 801
Fax: 574 3681

Shamiah

Tel: 801 801
Fax: 484 6254

Sharq

Tel: 801 801
Fax: 243 0776

Shuwaikh

Tel: 801 801
Fax: 484 4126

Shuwaikh Medical

Tel: 801 801
Fax: 492 0206

Social Security (PIFSS)

Tel: 801 801
Fax: 247 2305

Souk Sharq

Tel: 801 801
Fax: 242 3473

Sour Street

Tel: 801 801
Fax: 243 0776

South Surra

Tel: 801 801
Fax: 987 6303

Surra

Tel: 801 801
Fax: 535 9686

Transport Centre

Tel: 801 801
Fax: 246 9923

Watya

Tel: 801 801
Fax: 244 0731

Yarmouk

Tel: 801 801
Fax: 532 2635

International Network

Bahrain

**National Bank of Kuwait SAK
Bahrain Branch**
Seef Tower, Al-Seef District 428
P.O. Box 5290, Manama
Bahrain
Tel: +973 17 583 333
Fax: +973 17 587 111

Jordan

**National Bank of Kuwait SAK
Amman Branch**
Shareef Abdul Hamid Sharaf St
P.O. Box 941297
Shmeisani, Amman 11194
Jordan
Tel: +962 6 560 8800
Fax: +962 6 560 8811

Saudi Arabia

**National Bank of Kuwait SAK
Jeddah Branch**
Al-Andalus Street, Red Sea Plaza
P.O. Box 15385
Jeddah 21444, Saudi Arabia
Tel: +966 2 653 8653
Fax: +966 2 653 8653

Qatar

**International Bank of Qatar (QSC)
(Associate Company)**
Suhaim bin Hamad Street
P.O. Box 2001
Doha, Qatar
Tel: +974 447 3700
Fax: +974 447 3710

Iraq

**Credit Bank of Iraq
(Associated Company)**
Street 9, Building 178
Sadoon Street, District 102
P.O. Box 3420
Baghdad, Iraq
Tel: +964 1 7182198/7191944/
+964 1 7188406/7171673
Fax: +964 1 7170156

Lebanon

**National Bank of Kuwait
(Lebanon) SAL**
Sanayeh Head Office
BAC Building, Justinien Street,
PO Box 11-5727, Riad El-Solh
1107 2200 Beirut
Tel: +961 1 741 111/742 222
Fax: +961 1 747 846/747 866

Achrafieh Branch
Tel: +961 1 201 680
Fax: +961 1 201 763

Chiah Branch
Tel: +961 1 270 176
Fax: +961 1 270 177

Dora Branch
Tel: +961 1 899 530
Fax: +961 1 898 903

Hamra Branch
Tel: +961 1 353 416
Fax: +961 1 349 825

Mazraa Branch
Tel: +961 1 317 076
Fax: +961 1 701 025

Jounieh Branch
Tel: +961 9 639 951
Fax: +961 9 639 954

Aley Branch
Tel: +961 5 556 501
Fax: +961 5 556 504

Bhamdoun Branch
Tel: +961 5 260 100
Fax: +961 5 260 102

Broumana Branch
Tel: +961 4 860 660
Fax: +961 4 860 662

United Kingdom

**National Bank of Kuwait
(International) Plc
Head Office**
13 George Street
London W1U 3QJ, UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

**National Bank of Kuwait
(International) Plc
Portman Square Branch**
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

**NBK Investment
Management Limited**
13 George Street
London W1U 3QJ, UK
Tel: +44 20 7224 2288
Fax: +44 20 7224 2102

France

**National Bank of Kuwait
(International) Plc
Paris Branch**
90 Avenue des Champs-Elysees
75008 Paris, France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore

**National Bank of Kuwait SAK
Singapore Branch**
9 Raffles Place #51-01/02
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

Vietnam

**National Bank of Kuwait SAK
Vietnam Representative Office**
Room 2006, Sun Wah Tower
115 Nguyen Hue Blvd, District 1
Ho Chi Minh City
Vietnam
Tel: +84 8 827 8008
Fax: +84 8 827 8009

China

**National Bank of Kuwait SAK
Shanghai Representative Office**
Suite 1003, 10th Floor, Azia Center,
133 Yin Cheng Bei Road, Lujiazui,
Shanghai 200120
China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

United States of America

**National Bank of Kuwait SAK
New York Branch**
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

NBK Capital

**Kuwait
NBK Capital**
17th Floor, Dar Al-Awadi Building
Ahmed Al-Jaber street, Sharq, Kuwait
PO Box 4950, Safat, 13050
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United Arab Emirates

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UAE**
Precinct Building 3, Office 404
Dubai International Finance Center
PO Box 506506, Dubai
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Tel: +971 4 365 2800
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Turkey

**NBK Capital
Arastirma ve Musavirlik AS**
SUN Plaza, 30th Floor
Dereboyu Sk. No:24
Maslak 34398, Istanbul, Turkey
Tel: +90 212 276 5400
Fax: +90 212 276 5401