DUNIA REPORT

Iraqi Private Sector Banking

Top Picks, Unmatched Opportunity: January 2014

Dunia Frontier Consultants
A SanctaCapital Group Affiliate
Washington DC | Dubai
www.duniafrontier.com

© Dunia, LLC 2014

Executive Summary

From September to December 2013, Dunia Frontier Consultants conducted a series of comprehensive surveys of Iraqi private bank investors as well as corporate and retail customers. From the customer standpoint, we sought to understand retail and corporate deposit and borrowing attitudes, as well as brand recognition. From the investor perspective, we wanted to identify the key concerns about Iraqi banks as potential investments and gauge investor opinions on corporate governance and transparency. Further, the investor survey provided interesting insights into the catalysts driving the development of private sector banking lending, deposit growth, and share prices. In total, we conducted over 60 interviews across the three groups.

We paired our survey results with additional on the ground research to examine the broader environment, including the economy, politics, and security, as well as fiscal, monetary, and bank regulatory policy, for a 360-degree, comprehensive view of the Iraqi private banking sector. We analyzed the financial statements of 14 Iraqi banks in detail, augmenting the published data with our own calculations to bridge gaps where necessary. Many insights were also gathered from Dunia's own five-year experience as a leading on the ground researcher serving multinationals and local companies in Iraq. As a result, we believe that this research report is the only report of its kind, in terms of comprehensiveness, rigor and on the ground fact base.

The following is a selected summary of our conclusions:

- **Unmatched macroeconomic opportunity.** Iraq is expected to sustain growth rates above 8% per annum through the rest of the decade, making it one of the fastest growing economies in the world. Much of this growth is driven by a resurgent oil industry, as oil revenues are translated into infrastructure development and the country recovers from 25 years of war and sanctions. This unmatched growth carries its own risks, however, notably the near term political and security situation. But on balance, we believe the macroeconomic risk/reward profile is strongly positive.
- **Banking sector play.** The private sector banking industry is particularly well placed, as it will play a central role in this economic resurgence and represents the largest segment of the Iraqi Stock Exchange. Further, private banks will finish raising significant capital in the next six months, which will likely lead to rapid earnings growth as that new capital is deployed, as well as the potential for dividends. When we looked at the top 14 banks in our analysis, the enormous opportunity was highly evident, as the average 3-year CAGR for loan growth from 2009 to 2012 was 52%, with the highest individual bank's CAGR at 163%. For deposits, the average CAGR was 28%.
- **Over the longer term, the banks with the best services and reputations will lead the market.** Our survey helped us identify which characteristics were the best measures of both service quality and reputation, as measured by customers and investors. This contributes to the bank's chances of business success and lower risk profile in terms of transparency and governance. Simple in concept, this often comes back to a bank's leadership, talent base and professionalism. And the concept can only be measured through on the ground customer and investor insights, especially in an opaque market like Iraq. This is where our surveys, coupled with solid financial analysis, provide an answer.

The content of this report is confidential and proprietary, and intended for the exclusive use of Dunia's Client. Dunia shall have no liability arising from any use made of this report, or any part of it, to the fullest extent permitted by law. No part of this report may be reproduced in any form. Further distribution without written consent of Dunia is prohibited. Copyright © 2014. All rights reserved.

- **Weighing the right measures of 'bank quality.'** We selected seven key metrics from our financial analysis, added four metrics from our survey, and a strategic investment metric, to screen for the best banks among a list of 14 top banks. We then used a normalized 10-point system across the three categories, financial, survey, and strategic investor, with weights of 50%, 25% and 25%, respectively, to ensure a balance of quantitative and qualitative measures.
- **Charting quality against value.** To identify our top banks, we mapped the resulting overall quality score to valuation, using both price/earnings (P/E) and price/book (P/B) (see Chart 1 and Chart 2). While P/E is generally the default metric for assessing bank valuations, we favor P/B at this point as it is better marked to market, and is less likely to have been distorted by the past 24 months of capital raising and share dilution. We found a positive, though weak, correlation between quality and value (as shown in the regression line in Chart 1 and Chart 2), which shows that although the ISX is moving in the right direction, it remains inefficient at this point.
- **Our top bank picks.** Our top four banks were, in order of preference …

[Available in the full report]

Based on our analysis, we are confident that a basket of top quality private banks can provide favorable risk/reward characteristics, despite the acknowledged uncertainties in Iraq, both at the macro and bank-specific level. Further, given the uniqueness of the market, Iraqi banks present robust diversification and high-conviction sources of alpha within a well-managed long-term portfolio.

Sincerely,

Kyle Stelma
Managing Director
Emerging Markets

The content of this report is confidential and proprietary, and intended for the exclusive use of Dunia's Client. Dunia shall have no liability arising from any use made of this report, or any part of it, to the fullest extent permitted by law. No part of this report may be reproduced in any form. Further distribution without written consent of Dunia is prohibited. Copyright © 2014. All rights reserved.

Table of Contents

Executive Summary **2**

I. Iraq country overview and key macro considerations **9**
- Oil, demographics, infrastructure drive rapid GDP growth 9
- Fiscal and monetary policy currently stable, with minor threats 13
- Politics and security likely to remain an issue 15
- Investment climate strong despite challenges 18

II. Banking Sector Analysis **21**
- Background 21
- Current state of banking in Iraq 21
- The Iraqi banking experience 29
- Potential regulatory considerations 31
- The competitive evolution of private sector banking in Iraq 36
- The growth story 37

III. A comparison of selected private banks **40**
- Financial metrics 41
- Survey metrics 49
- Foreign ownership 54

IV. Conclusion and recommendations **56**
- Bank analysis 56
- General comments 64
- Top company picks 65

V. Reference Tables: financial and other data **68**

VI. Appendix: Full survey and analysis **72**
- Retail customer survey and analysis 72
- Corporate customer survey and analysis 96
- Investor survey and analysis 110

The content of this report is confidential and proprietary, and intended for the exclusive use of Dunia's Client. Dunia shall have no liability arising from any use made of this report, or any part of it, to the fullest extent permitted by law. No part of this report may be reproduced in any form. Further distribution without written consent of Dunia is prohibited. Copyright © 2014. All rights reserved.

Table 1. Summary data: bank quality rating versus Price/Book and Price/Earnings valuations for Dunia selected banks.

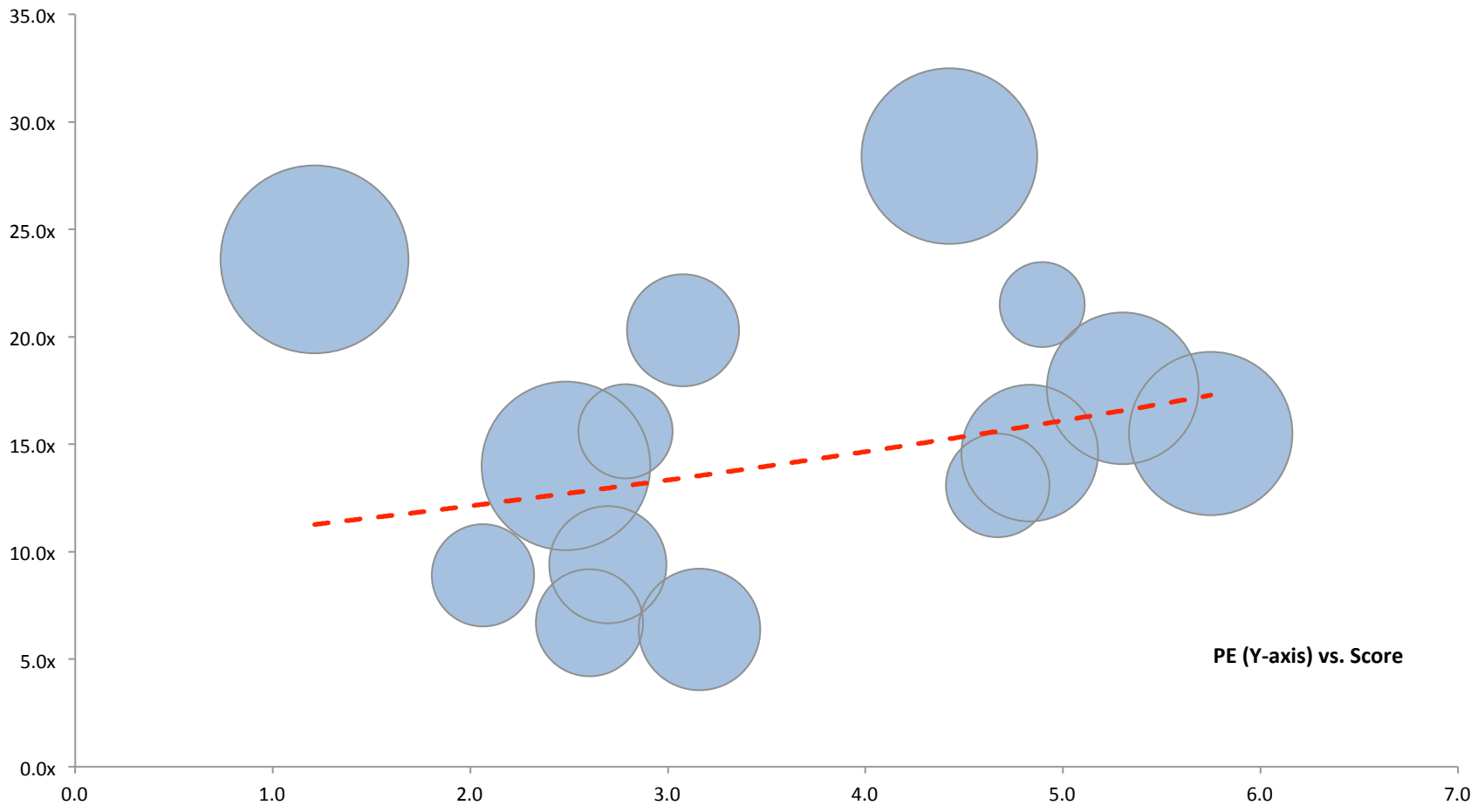
Banks	Ticker	Score	PE	PB	Market Cap (US$, mn)
Bank of Baghdad	BBOB	x.x	x.x	x.x	x.x
North Bank	BNOR	x.x	x.x	x.x	x.x
Kurdistan Int. Bank	BKUI	x.x	x.x	x.x	x.x
Al-Mansour Bank	**BMNS**	**5.3**	**17.6x**	**1.6x**	**362**
United Bank	BUND	x.x	x.x	x.x	x.x
Dar Es Salaam Inv. Bank	BDSI	x.x	x.x	x.x	x.x
Gulf Commercial Bank	BGUC	x.x	x.x	x.x	x.x
Credit Bank of Iraq	BROI	x.x	x.x	x.x	x.x
Economy Bank	BEFI	x.x	x.x	x.x	x.x
Mosul Bank	**BMFI**	**2.6**	**6.7x**	**0.9x**	**180**
Investment Bank of Iraq	BIBI	x.x	x.x	x.x	x.x
National Bank of Iraq	BNOI	x.x	x.x	x.x	x.x
Iraqi Islamic Bank	BIIB	x.x	x.x	x.x	x.x
Commercial Bank of Iraq	BCOI	x.x	x.x	x.x	x.x

Source: Rabee Securities, Dunia analysis.

Note: Market data is as of December 31, 2013.

The content of this report is confidential and proprietary, and intended for the exclusive use of Dunia's Client. Dunia shall have no liability arising from any use made of this report, or any part of it, to the fullest extent permitted by law. No part of this report may be reproduced in any form. Further distribution without written consent of Dunia is prohibited. Copyright © 2014. All rights reserved.

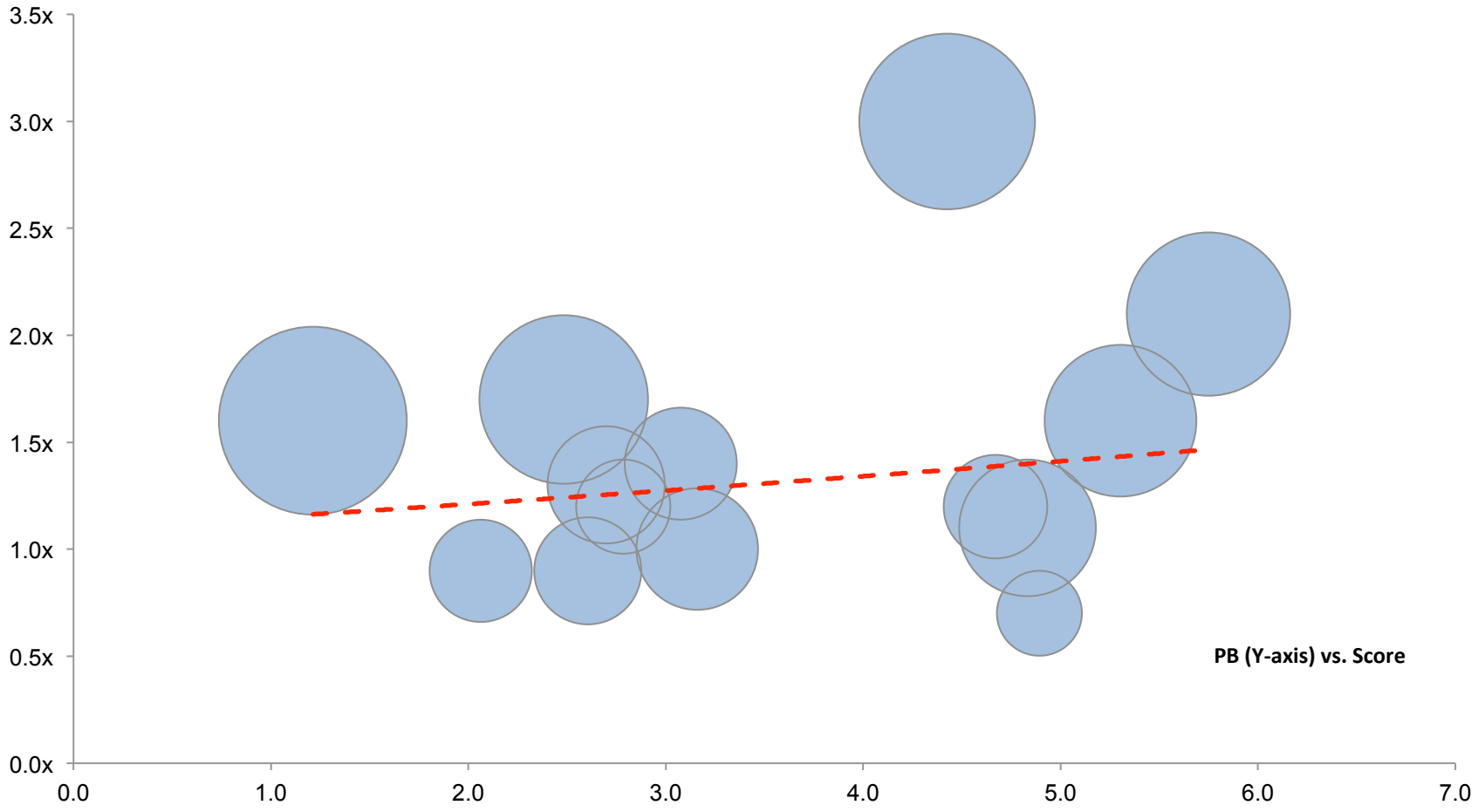
Chart 1. Plot of bank quality rating versus Price/Earnings valuation for Dunia selected banks, with regression line



Note: Bubble area is proportional to current market capitalization in US$ mil.

The content of this report is confidential and proprietary, and intended for the exclusive use of Dunia's Client. Dunia shall have no liability arising from any use made of this report, or any part of it, to the fullest extent permitted by law. No part of this report may be reproduced in any form. Further distribution without written consent of Dunia is prohibited. Copyright © 2014. All rights reserved.

Chart 2. Plot of bank quality rating versus Price/Book for Dunia selected banks, with regression line.



Note: Bubble area is proportional to current market capitalization in US$ mil.

The content of this report is confidential and proprietary, and intended for the exclusive use of Dunia's Client. Dunia shall have no liability arising from any use made of this report, or any part of it, to the fullest extent permitted by law. No part of this report may be reproduced in any form. Further distribution without written consent of Dunia is prohibited. Copyright © 2014. All rights reserved.

About Dunia Frontier Consultants

With offices in Washington DC, Dubai and Kampala, Dunia Frontier Consultants (DFC) provides consulting services to investors and corporations operating at the frontiers of 21st century business. Dunia works closely with a small number of clients internationally to provide an unparalleled level of service. With a world-class staff and highly efficient global network of consultants and partners, we support your endeavors in several key areas:

- **Emerging Markets Investment.** The heart of our business, we offer a full suite of financial services, including deal sourcing, due diligence, valuation, and market survey support;
- **Risk Reporting and Analysis.** Anchored by rigorous data collection and subject matter expertise, we organize and deploy research teams across the Middle East, Africa and South Asia to help our clients mitigate risks and optimize decision-making in key transactions;
- **Business Development.** With well-developed local networks in the world's financial capitals and across key emerging markets, we identify prime market opportunities and business partners for our clients, and provide essential insights to help them navigate new markets.
- **Information Networking and Design.** We develop and refine research methodology and analytic tools to generate useful information for clients operating in data-poor and challenging business environments.

Dunia in Iraq

Dunia has performed dozens of due diligence and market surveys in the agriculture, banking, oil and gas, manufacturing, logistics, and real estate sectors of Iraq. Dunia recently completed an in-depth survey of the upstream oil and gas sector, a number of surveys of the housing and real estate markets of non-Baghdad locals, and continues providing actionable insights on developments in the Ministry of Oil, its operating entities, and with comprehensive analyses of the on-the-ground situation surrounding the major oil fields under development.

Contact:

Kyle Stelma
Managing Director
kyle.stelma@duniafrontier.com
971.50.925.9869

The content of this report is confidential and proprietary, and intended for the exclusive use of Dunia's client. Dunia shall have no liability arising from any use made of this report, or any part of it, to the fullest extent permitted by law. No part of this report may be reproduced in any form. Further distribution without written consent of Dunia is prohibited. Copyright © 2014. All rights reserved.