

A golden proposition

With the gold price now clearly above USD1,000 per ounce and poised for continued strength in the medium term, the GCC region merits attention as an increasingly important hub for the global gold industry. Exceptional growth potential exists across the value chain thanks to a sizeable and loyal consumer base, potentially large untapped mineral resources, and deepening regional expertise in manufacturing, wholesale and retail. While the high volatility in gold prices has thrown up short-term challenges, the strong structural growth drivers for the sector promise attractive medium and longer-term opportunities. Moreover, with the GCC economies set to be among the first to recover from the global downturn, the region is well positioned to further enhance its position as a gold manufacturing and trading hub of global importance.

- **We believe that, in spite of record high prices, future prospects for gold remain very favorable in the near to medium term.** A tight demand-supply balance and growing investment demand should make gold a resilient investment and its price, in spite of recent gains, remains well short of its historical inflation-adjusted peak. Gold has also regained favor with central banks as concerns mount about the dominance of the US Dollar.
- **The Gulf region is characterized by a young, rapidly growing and relatively wealthy population with longstanding cultural attachment to gold as a gifting item, fashion accessory, and a store of value.** The region is by far the world's leading consumer of gold in per capita terms and the regional demand is highly resilient in value terms. Jewelry represents more than 90% of the physical gold purchased. Growth in the region's top two gold retail markets — Saudi Arabia and the UAE — is primarily driven by strong domestic demand and tourism respectively.
- **The Arabian Shield boasts attractive opportunities in gold mining.** Recent studies show that only 20% of known and inferred gold resources in Saudi Arabia are being exploited. Regulatory changes initiated by the Saudi Arabian Government have smoothed the way for local and foreign private sector investments. Although the existing ageing mines have lost their previous cost advantages, the situation could quickly change with several new projects in the pipeline.
- **The GCC's gold jewelry manufacturing offers attractive growth potential, not least through import substitution, since imported finished products currently constitute approximately one-third of jewelry sold in the region.** In addition, the quality of gold jewelry, acquired manufacturing and design capabilities of regional manufacturers, and uniformity in consumer tastes across the Middle East promise substantial export opportunities.
- **Although physical gold remains by far the favored vehicle among regional investors interested in gold, a handful of listed companies now offer indirect opportunities.** The most important among these are the Saudi miner Ma'aden (1211.SSE) and the retailer Damas (DAMAS.DIFX). The Australian miner Citadel Resources Group (ASX:CGG) is active in Saudi Arabia. The Tadwul-listed Fitaihi Holding (4180.SSE) designs and sells gold jewelry among other luxury products.

GCC: A leading hub of global gold consumption

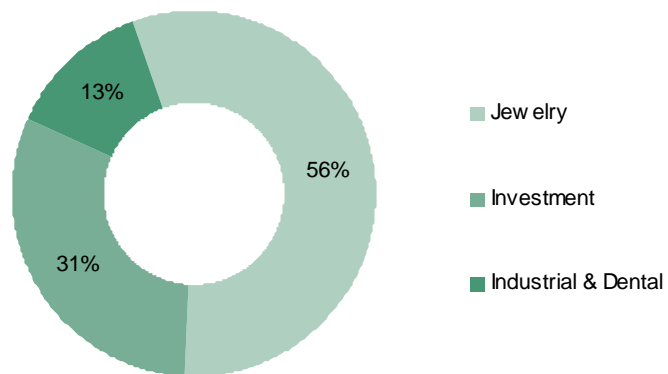
The GCC precious metals sector has, at least until recently, been decisively dominated by gold jewelry sales

Gold demand is primarily driven by jewelry, which traditionally constituted two-thirds of the total global demand

The recent history of the GCC precious metals industry is above all a story of gold jewelry sales. By contrast, the other parts of the precious metals value chain are relatively less well developed and of much more recent origin, at least in terms of their modern development. Mining, of course, boasts antecedents dating back millennia, but the sector has seen minimal activity in the modern era. The GCC region is one of the world's leading markets for gold jewelry with the highest levels of per capital consumption in the world. Driven by tradition and culture, the local gold market is exceptionally resilient, especially in value terms.

Global demand for gold comprises three components: jewelry, investment, industrial and dental (including electrical). In addition to demand from individuals and financial investors, central banks and international financial institutions are major repositories of gold, largely but not exclusively, as a legacy of the Gold Standard and the post-war Bretton Woods system that until 1971 linked the US Dollar to gold. Excluding central bank demand leaves us with what is known as 'identifiable demand for gold' (hereafter referred to as gold demand). This mainly comprises jewelry demand, which accounts for almost two-thirds of the total. Apart from the traditional jewelry demand, investment demand has been gaining importance as investors have once again turned to gold as an attractive hedge and a reliable source of value in times of global economic uncertainty, precisely as happened in the 1970s.

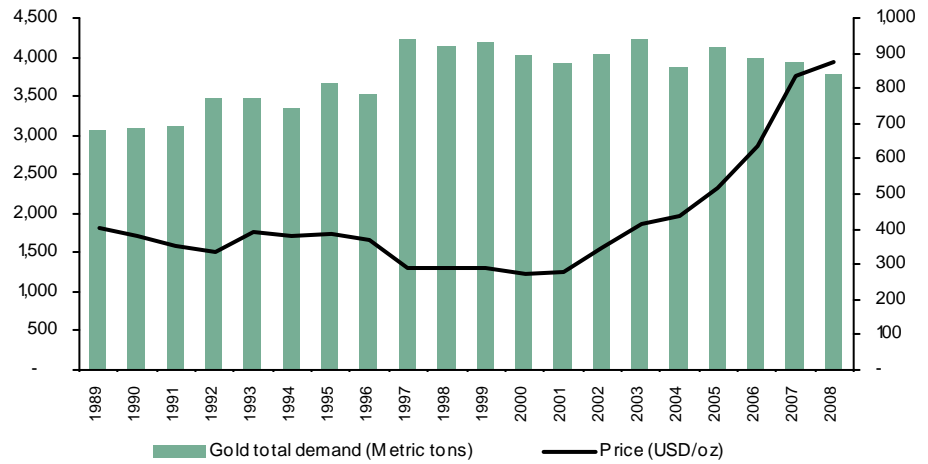
Figure 1: Global identifiable demand for gold by category , 2Q-09.



Source: World Gold Council (WGC)

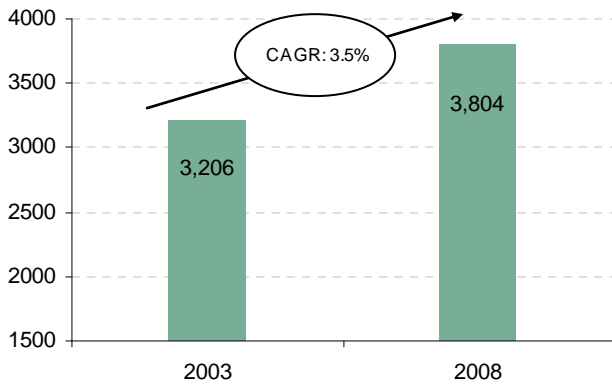
Global gold demand increased steadily in volume terms during 1989–1997, after which it broadly stagnated until 2003. However, a steady rise in prices continued to push up the total in value terms. During 2003–2008, the average annual aggregate increase in the volume of gold purchases was 3.5%, to 3,804 tons, but rising prices pushed up value by a compound annual growth rate of 23.1% to around USD105.8bn.

Figure 2: Total identifiable demand for gold 1989-2008, tons



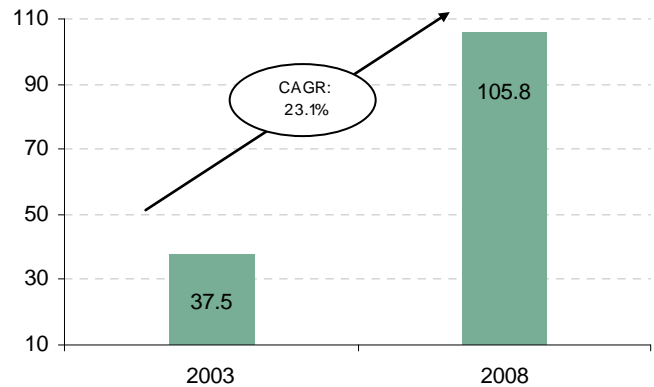
Source: GFMS, Bloomberg, NCBC Research

Figure 3: Total global identifiable gold demand¹ in volume terms (tons)



Source: World Gold Council, GFMS

Figure 4: Total global identifiable gold demand in value terms, based on average annual price (USD bn)

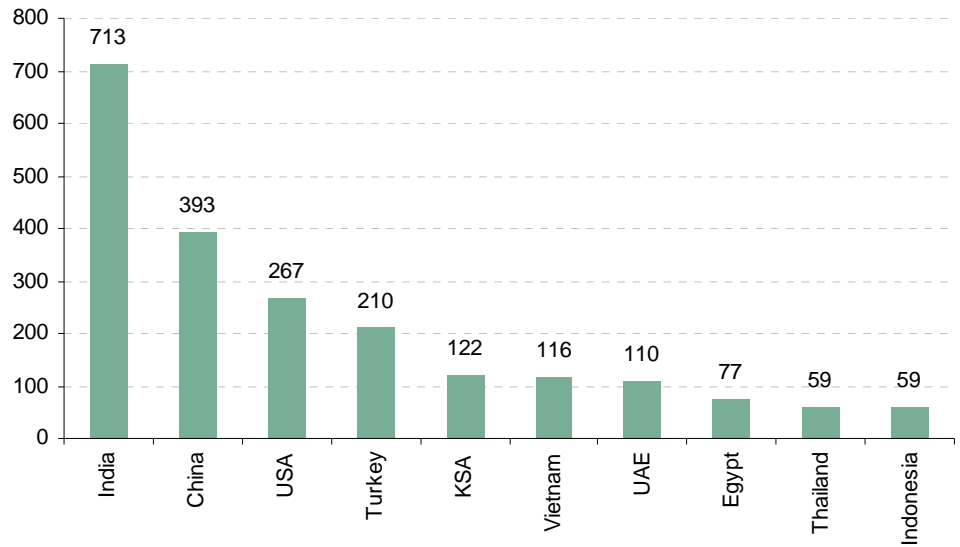


Source: World Gold Council, GFMS

Global gold demand is heavily concentrated in a few key markets, most notably India, China, the US, Turkey, and the GCC. Within the GCC, Saudi Arabia and the UAE are the largest national markets. Taken together, they are comparable in importance to the US.

¹ Total global demand includes demand for fabrication, bars & coins, other retail investment and demand for ETFs and similar products

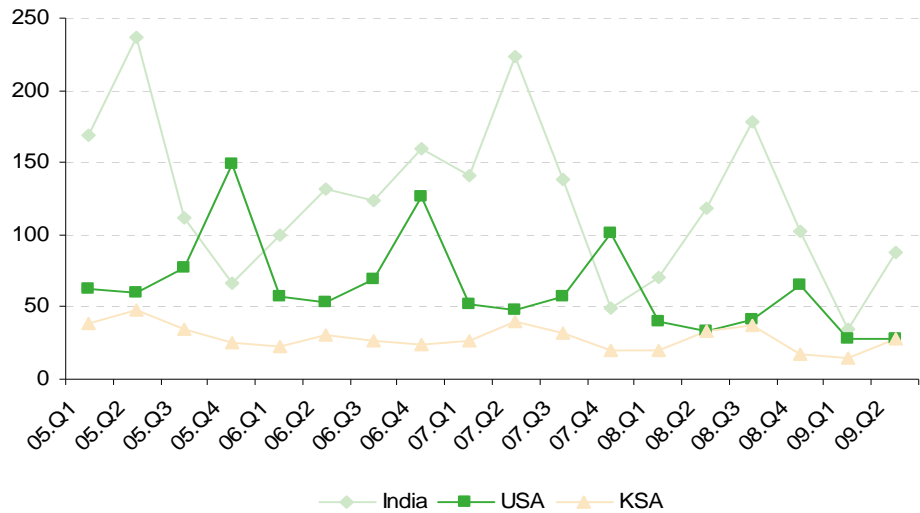
Figure 5: Top ten physical gold markets 2008 (tons)



Source: GFMS

The various segments of gold demand manifest different patterns over time. Gold jewelry demand is heavily seasonal, driven in many countries by social, cultural and religious events (e.g. Christmas season in the West and weddings and religious celebrations in emerging markets such as the Middle East and Asia). By contrast, investment demand is linked to price expectations and perceived levels of economic uncertainty.

Figure 6: Quarterly gold jewelry demand in key markets (tons)

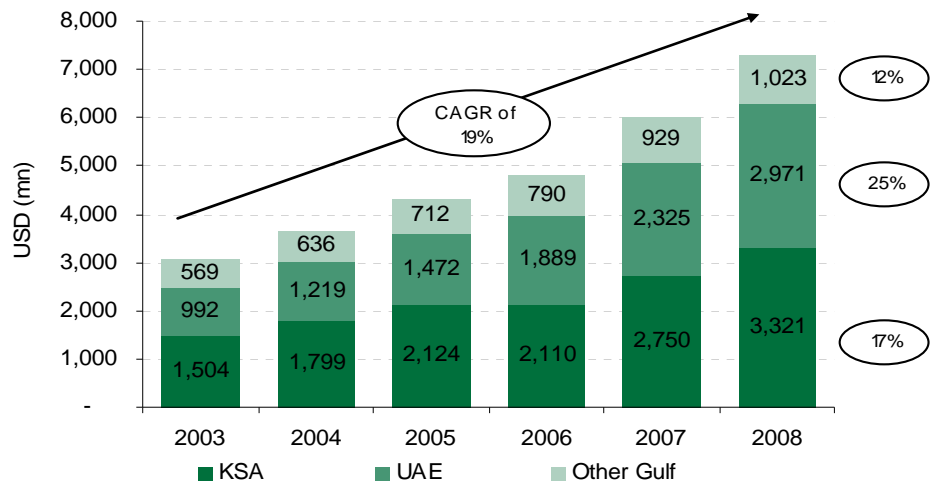


Source: GFMS

A dynamic market

The GCC is a leading hub of global gold consumption with a total estimated market size in 2008 of USD7.4bn or 262.8 tons. This constitutes approximately 9% of total global market size and has grown at 19% compound annual growth rate (CAGR) during the past six years, roughly matching the aggregate global trend. The far greater importance of jewelry demand is the main feature that differentiates the Gulf from the global market. Jewelry represents approximately 90% of the total gold purchases in the region versus the global average of just under two-thirds.

Figure 7: GCC gold market (USD mn)

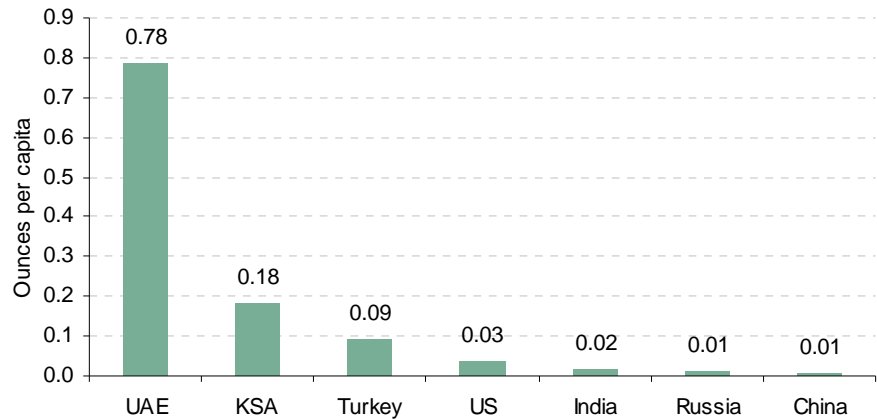


Source: GFMS

The GCC market is decisively dominated by the two leading regional economies, Saudi Arabia and the UAE, which now are roughly equal in importance following faster growth by the UAE in recent years. Demand in Saudi Arabia, which in 2003-2008 made up 48% of the regional total, is above all driven by its sizeable domestic market, bolstered by favorable economic and demographic factors. Dubai's buoyant retail tourism and role as a transit trade hub has significantly boosted the UAE market which grew at a compound annual growth rate of 25% over the last 6 years. The UAE gold market has further benefited from targeted Government initiatives to enhance Dubai's historic role as a regional gold trading hub. Key recent measures include the establishment in 2002 of the Dubai Multi Commodities Centre (DMCC) and the Dubai Gold and Commodities Exchange (DGCX) which began operations in 2005.

The exceptional nature of the GCC gold market becomes even more apparent from data on per capita gold consumption. In this regard, the region decisively eclipses other leading gold-consuming countries in the world, an advantage further enhanced by strong demographics. As of 2008, KSA per capita jewelry demand was nearly ten times the per capita gold consumption of India and more than seven times that of the US.

Figure 8: Five year average per capita consumption of gold in ounces



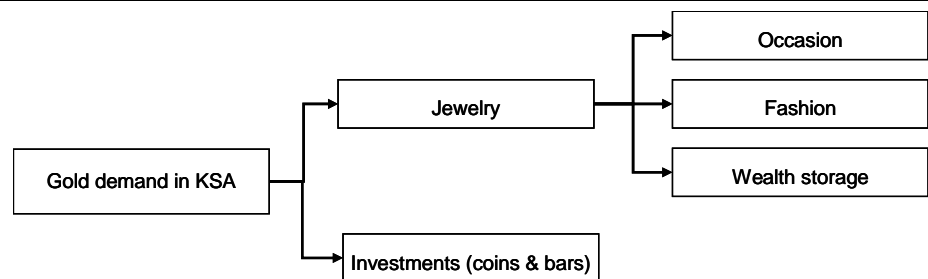
Source: World Gold Council, International Monetary Fund (IMF)

Saudi Arabia: The leading gold market in the Gulf

The Saudi Arabian gold market is largely a jewelry market with the other demand segments comprising 11% of the total market in 2008. However, jewelry demand in Saudi Arabia does have elements of overlap with other types of demand, notably investment. The jewelry market in turn can be classified into three segments:

- Occasion-driven: jewelry purchases for gifting during social celebrations such as weddings and births and religious events such as the Eids and the Hajj. Typical purchases include sets, rings, bracelets and chains.
- Fashion-driven: jewelry purchases typically made by young female consumers of products involving fashionable designs, intended for daily use or attendance of social events.
- Wealth storage: jewelry purchases primarily as personal savings; items include basic bangles and chains, typically of high-karat gold.

Figure 9: Structure of KSA gold demand



Source: Eastgate Analysis

Across all segments, the most sought-after features in gold jewelry items are:

- design, measured by sophistication,
- compatibility with local tastes and trends with product quality measured by robustness, gold purity and finishing

(iii) brand familiarity and trust

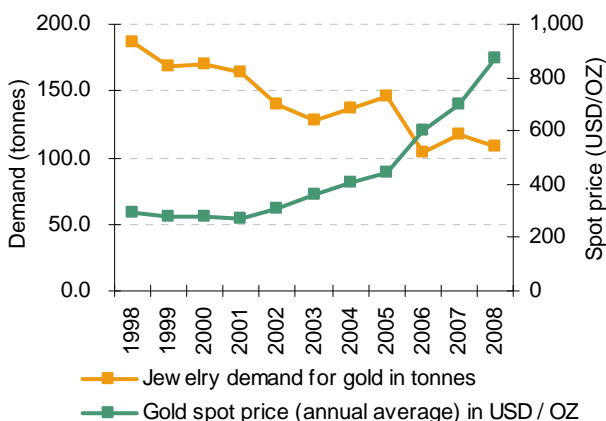
Social and religious events represent one of the main drivers of gold jewelry demand in Saudi Arabia and are estimated to comprise as much as half of the total demand. Of an estimated 10-15 million jewelry items sold annually in the Kingdom, a sizeable portion is linked to approximately 700,000 annual births and 50,000 weddings. Gold remains a preferred form of gifts and every event triggers multiple offerings. An indication of the importance of social and religious occasions in the Saudi Arabian jewelry market is its highly seasonal nature. Jewelry consumption peaks in the second quarter of the year, traditionally the season for weddings and other ceremonies, when demand typically exceeds the average for the rest of the year by 25-50%.

Despite the traditional dominance of jewelry, Saudi Arabia's gold investment market grew robustly over the past few years, in line with global trends. This expansion is mostly linked to the increasing perception of gold as a safe investment during uncertain times, given the volatile performance of many other asset classes. The share of investment demand grew from 4% in 2003 to 11% in 2008.

Jewelry demand sensitivity to price movements and the economic environment

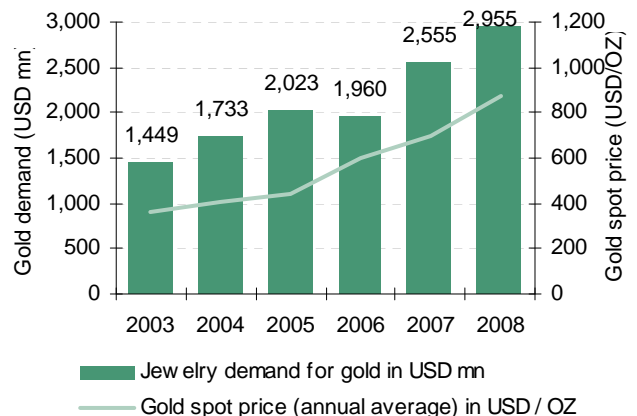
Gold jewelry demand, measured in volume terms, is relatively sensitive to price fluctuations and volatility. However, the Saudi Arabian market has been remarkably resilient in value terms. This is explained by the overriding cultural significance of gold jewelry and the importance of tradition and occasion-driven gifting as the main driver of this demand. Much of the occasion-driven demand is relatively inelastic in value terms, although the amount of physical gold gifted may vary with price. Social norms determine the expected value range of the gold gifted, based on socio-economic status, the nature of the occasion, and the type of relationship.

Figure 10: Price sensitivity of KSA gold jewelry demand in volume terms



Source: World Gold Council , EIU

Figure 11: KSA jewelry market resilience in value terms

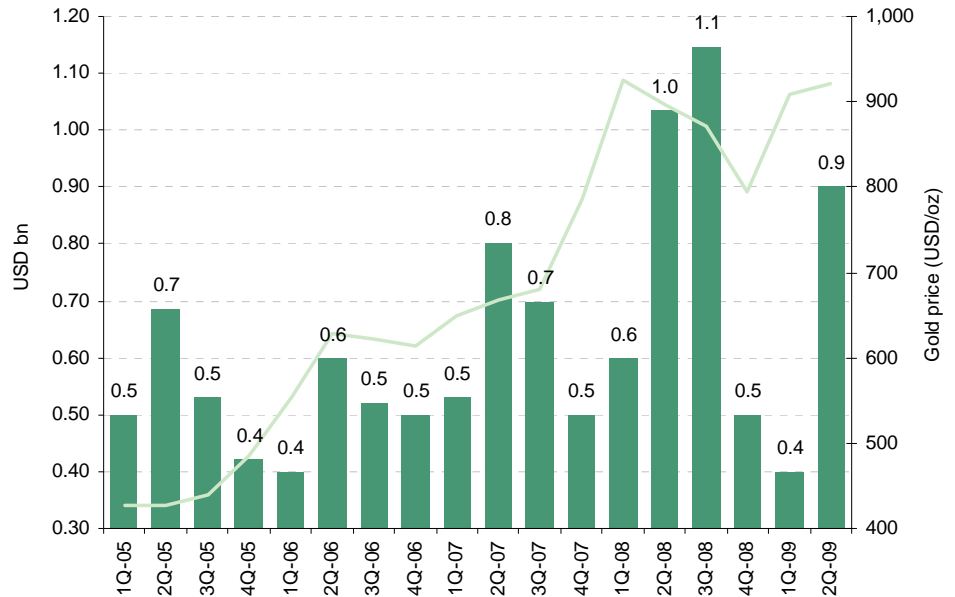


Source: World Gold Council, EIU

A closer look at the recent Saudi demand data shows that purchases peaked in the second and third quarters of 2008. Saudi consumers appear to have turned to gold jewelry in response to expectations of further price increases and general economic uncertainty. However, the trend

was reversed during the first half of 2009, possibly (at least partly) in response to signs of economic stabilization.

Figure 12: KSA quarterly gold jewelry demand and gold price



Source: World Gold Council, GFMS

Nonetheless, the Saudi Arabian jewelry market fared better than the rest of the world in 2Q-09. The Saudi demand for gold jewelry dropped by 17% in volume terms compared to the same period in 2008, whereas global demand volumes declined by 22% annually in 2Q-09. Some leading global markets such as India, Turkey and Russia shed as much as 30-54%.

The element of jewelry demand that is primarily motivated by wealth storage considerations tends to be linked to the level of personal savings and the perceived gold price outlook, especially in relation to other asset classes. The general popularity of gold and ease of disposal make it an attractive savings option, especially compared with other more inflation-exposed assets such as cash, or less liquid assets such as real estate. The resilience of social norms and consumer attitudes make the gift-giving and wealth preservation segments of gold demand relatively immune to business cycle variations.

By contrast, the fashion segment tends to be more sensitive to price fluctuations, as it is driven by interest in specific jewelry items whose prices, nonetheless, naturally track gold prices. Given the discretionary nature of spending on fashion jewelry, it may be affected by decisions to postpone or cancel purchases in times of economic stress or uncertainty. Although the fashion jewelry segment is sensitive to economic downturns, it is more resilient than other types of fashion purchases such as clothing or accessories owing to the value retention characteristics. For these reasons, it may benefit from some substitution effect.

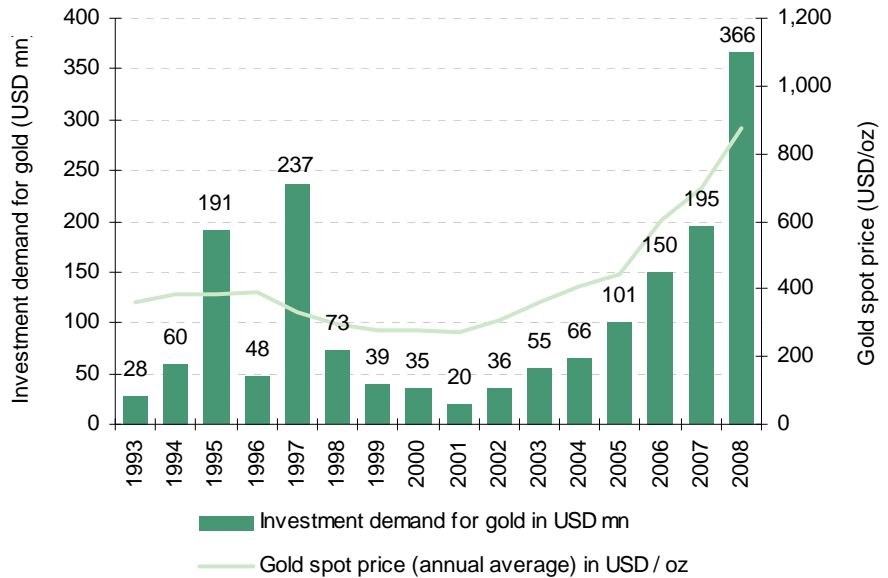
Investment demand for gold gaining ground

Historically, the nature of gold as a scarce commodity with intrinsic value has given it an advantage over financial investment such as equities and cash. Moreover, gold is often seen as a means to balance or even minimize investment risks and diversify portfolios.

Interest in gold typically increases when other asset classes are perceived to be unstable or risky. This has historically been the case in times of elevated inflationary expectations and

economic instability. These considerations explain the surge in investment demand globally and in the Gulf in recent years. In particular, the GCC region experienced an unusual period of elevated inflation in 2006-2009, as well as sharp swings in oil price and fragile investor sentiment following the global downturn. As inflation in KSA surged from 0.2% in 2002 to 9.9% in 2008 and the Saudi Arabian stock exchange corrected sharply in 2006 and in 2008, investment demand for gold over 2002-2008 increased at 15.8% CAGR in value terms to USD3.4bn in 2008.

Figure 13: Investment demand for gold and gold price



Source: World Gold Council, EIU

Mining: Potentially large untapped opportunities

Recognizing its potential, the Saudi Arabian Government is focusing on developing mining as a key growth driver

History and evolution

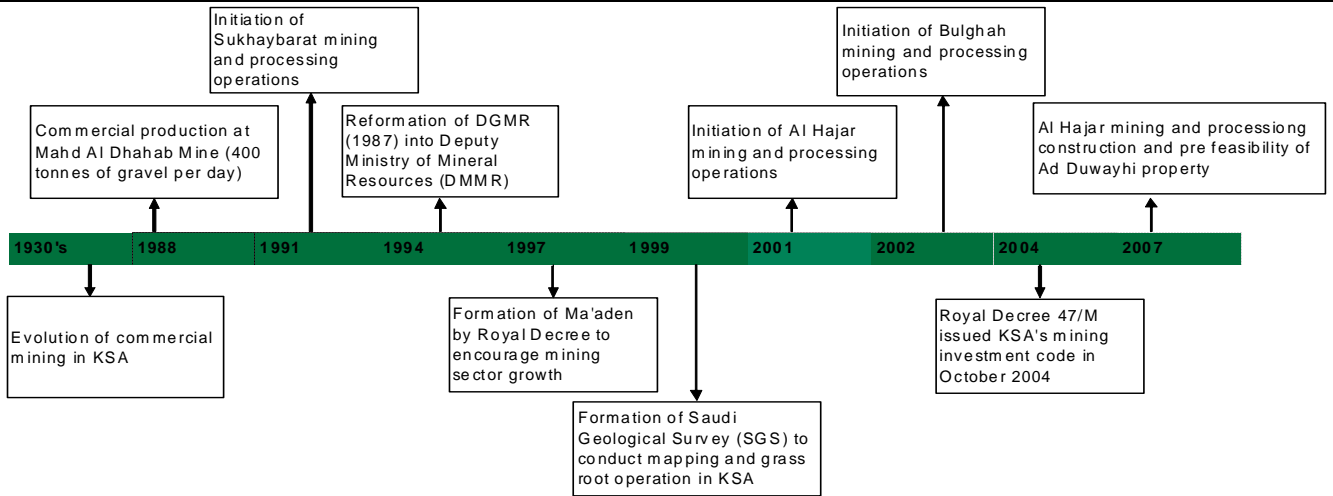
Even though mining in the Arabian Peninsula goes back several millennia, extraction of minerals in the modern era has been largely confined to oil and gas. Even efforts to chart the region's mineral wealth through systematic surveys are recent and typically far from complete. Although commercial mining activities in Saudi Arabia trace back to the 1930s, definitive steps to develop the sector were taken only in 1980s in the fourth Five-Year Plan (1985-1989). Some gold and silver mining has also taken place in Oman while the Yemeni Government has taken some steps to stimulate the sector. In general, the best prospects for mining exist in the mountainous west and south of the Arabian Peninsula.

In practice, extraction of precious metals in the GCC is almost exclusively a story of the Saudi Arabian gold mining sector. Although Saudi Arabia only accounts for 0.24% of total global gold mining, the proportion is expected to grow. By contrast, initiatives elsewhere in the region have typically been limited in duration and fairly modest in scale. However, a number of efforts are underway to encourage exploration and investment. During the decade starting 1983, Oman Mining Company (OMCO) mined copper and silver in the area near Sohar. In 1995, OMCO launched a processing plant to extract gold and silver from copper oxide deposits near Yanqul. However, production volumes have slid from a peak of 1,029 kg in 2000 and the resources are now largely depleted. The Omani Directorate General of Minerals has prepared six blocks in the northern region of the country for copper and gold exploration and prospecting. The National Mining Company of Oman has been active in the area since 2000 and has successfully located some copper and gold deposits estimated at 30mn tons. Yemen has at least 40 known occurrences of gold ranging from volcanic and rock to sediment and supergene.

To date, Saudi Arabia has been the regional leader in including mining as a key component in its economic diversification strategy. The Kingdom boasts a vast resource base, most notably of bauxite, phosphate and gold and significant deposits of a variety of other minerals and metals, including silver, lead, zinc, uranium, iron ore and copper. Saudi Arabia's phosphate resources are currently estimated at 3.1bn tons, of which 1.6bn is deemed minable. The bauxite resources total 200mn tons while the gold resources are put at 284 tons.

A number of important steps were taken in the 1990s to create a comprehensive institutional and regulatory framework to support mining in the Kingdom. The Saudi Arabian Department of Mining and Mineral Resources (DMMR) was reorganized in 1994 and the Saudi Arabian Geological Survey (SGS) was established in 1999. The incorporation of the Ma'aden mining company in 1997 created the basis for systematic exploration and extraction. Ma'aden became a publicly listed company in 2008, although it remains over 60% government owned. Ma'aden has been under coverage by NCB Capital since 13 July 2009 and our current recommendation is underweight.

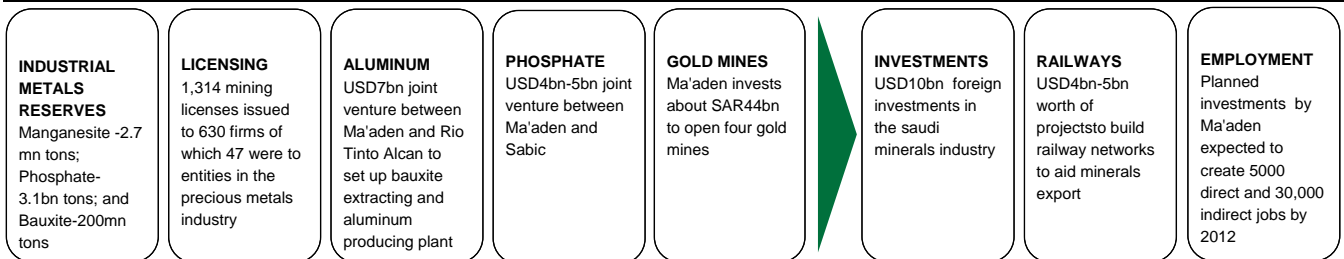
Figure 14: Evolution of the KSA mining sector



Source: NCBC Research

Progress in the mining sector over the past two decades has been fairly steady, supported by a growing stream of government-backed investments. Under the eighth Five-Year Plan (2005-2009), the government plans to invest around USD319mn in the sector, up almost 50% over funds allocated in the seventh plan. Furthermore, by the end of 2008, Ma'aden had a project pipeline worth USD18bn directed towards mining of phosphate, bauxite, magnesite and industrial minerals. The employment impacts of these ventures are put at as much as 5,000 direct jobs and up to 30,000 indirect positions.

Figure 15: KSA governments contribution to the development of mining sector



Source: SAGIA, NCBC Research

The KSA Government's strong commitment to support more systematic exploitation of the country's mineral wealth reflects in various infrastructural projects being planned or underway. These include the development of the Ras Al Zour mineral industrial complex that will include a port and captive power plants. The complex will be connected to phosphate mines at Al Jalamid through a 1,500km railroad network. Expected to be completed by 2012 with estimated investments of USD2.8bn, the venture promises to create employment opportunities for about 16,000 people. Other related infrastructure projects include the construction of huge Independent Water and Power Projects (IWPP) with the capacity of 3,600MW of electricity that will become operational in 2015 and 835,000 cubic meters of water per day.

Infrastructural projects of USD13.1bn are underway to support the Kingdom's mining sector

Table 1: Planned investments in KSA mining sector

Minerals/Infrast. projects	Planned investment (USD bn)	Estimated reserves/capacity	Details
Bauxite	10.5	200mn tons	Development of mine to metal Aluminum project by Ma'aden and Rio Tinto expected to commence by early 2012
Phosphate	5.6	3.1bn tons	Fertilizer plants with an annual capacity of 3.0mn tons; developed by Ma'aden in partnership with SABIC
Gold	1.0	284 tons	At present 5 operating mines and sixth likely to start production soon.
Power Plant	5.5	3,600MW	Power plants will be used by phosphate mines at Al Jalamid
Ras Al Zour Port	0.7		Developed by Ma'aden as an integral part of Ras Al Zour mineral industrial complex
Railway	3.5	2,500 km	Expected to be completed in 4Q-10

Source: Ma'aden, Zawya

Regulatory amendments support mining growth

Regulatory reform constitutes an important aspect of the efforts to support minerals extraction. Progress in this area has the potential to significantly reduce lead times for projects, minimize risks, and to open access to capital from a range of new sources. To date, the most systematic efforts to overhaul mining regulations have been made in Saudi Arabia, although similar efforts are underway elsewhere. For example, in April 2003, Oman adopted a new mining code, which significantly liberalizes investment in the sector. Since 2006, Yemen is reviewing its mining legislation with support from the International Finance Corporation (IFC). This builds on the recognition that, if properly developed, the mining sector will generate as much as 7% of Yemen's GDP and serve as an important source of export revenue. The UAE is also taking steps to chart out its mineral resource base more systematically.

New mining code has opened KSA's mining sector to private and foreign sector participants

The new Saudi Arabian mining law, implemented in January 2005, creates a regulatory environment designed to encourage private sector and foreign investor participation in the sector. Among other things, a level playing field was created for domestic and foreign players and all taxes and fees were capped at 20%. This can enhance transfer of new technology and know-how to the sector significantly, with the arrival of foreign mining companies with the strong expertise.

The provision for equal treatment of foreign and local investors under the new mining code has encouraged increased participation of foreign investors. Many of them view Saudi Arabia with great interest in view of declining production levels in a number of more established markets. Between the date of adoption of the new Mining Code and end of 2008, 1,406 licenses were issued to 700 mining companies that included:

- 59 exploration licenses (covering over 135,000 sq km) for exploration of precious metals, base metals, industrial metals and gemstones
- 97 scouting licenses (reconnaissance licenses), including 13 licenses granted to foreign entities to conduct preliminary explorations of mineral deposits in KSA
- 57 mining and raw material quarrying licenses (covering 1,207sq km), including 22 licenses for exploitation of cement, 21 licenses for exploitation of industrial minerals and 14 for precious metals, base metals, phosphate and bauxite
- 58 small mine exploration licenses for extraction of industrial minerals
- 1,148 building material and quarry licenses (covering 287mn sq meters) for exploration of marble, gypsum, limestone, granite, iron sand regular sand and gravel

The scope for investment is strong, as the Department of Mining and Mineral Resources has reserved 254 areas (53,000 sq kms) for mining activities in the Kingdom, with active investment interest being shown by local companies as well as those from Australia, South Africa, United States and United Kingdom.

Current situation: Small and ageing mines nearing depletion

Currently, Saudi Arabia has five operating mines with estimated cumulative ore reserves of 1.3mn ounces (40.2 tons). The progressive depletion of these mines has resulted in a continuous decline in Saudi Arabian gold production in recent years. Between 2004 and 2007, gold production from the five operating mines has declined 46% from 8.3 tons in 2004 to 4.4 tons in 2007. The launch of the new Al Amar facility in 1H-07 helped reverse the decline by increasing overall production to 5.7 tons in 2008. Nonetheless, the advanced stage of exploitation of the old Cradle of Gold deposits, the main mining center to date, means that the near-term outlook for the sector will critically depend on the ability of investors to bring new facilities online quickly and cost effectively.

Although the launch of a new gold mine in KSA increased production in 2008, new sites are needed to maintain output growth in the coming years

Operating mines in KSA

Ma'aden is exploiting all the currently operational gold mines in the Kingdom.

Al Amar: A newly commissioned facility, which began operations in 1H-07, Al Amar is located in the central Riyadh Province. The mine has a processing facility of 200 thousand metric tons per annum (ktpa) that produces gold in doré, copper and zinc concentrates that are sold to third parties for refining and smelting. The mine is expected to be ready for full-scale production this year. With around 722 thousand ounces (Koz) in resources, mining activity is expected to continue at the rate of 200 ktpa until the projected depletion of the ore reserves in 2014.

Mahd Al Dhahab: The oldest of the operating mines in the Kingdom, Mahd Al Dhahab is located in the Madinah province. Mahd Al Dhahab is an underground mine with a facility that processes 185ktpa of polymetallic ore into gold doré as well as copper and zinc concentrates that are sold to third parties for smelting and refining. The mine holds total gold resources of 643 koz (as of July 2007) constituting a grade of 16.1 gram per ton of gold (g/t Au). The mine operations currently focus on maintaining a constant level of operation until its expected depletion in 2012.

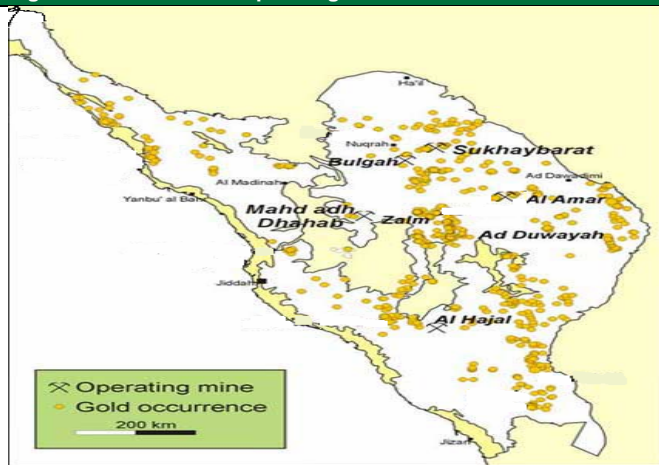
Bulghah: An open pit low-grade ore mine, located in the Madinah province, Bulghah commenced operations in 2002. The mine has a 4mn metric tons per annum (mtpa) heap leach processing plant. Bulghah contains total mineral resources of 617koz of gold with 0.8g/t of Au. Mining activities are set to continue until the projected depletion of ore reserves in 2010.

Al Hajar: A closed open-pit mine located in the south-western Asir province, its activities trace back to exploration in the 1980s. This led to the commissioning of a heap leach processing plant with a capacity of 750ktpa in 2001. Mining and processing activities at the mine continued until the depletion of ore reserves in 2006. The plant is currently used for re-crushing the material stacked and leached until October 2005. As of July 2007, Al Hajar contained total mineral resources of 87koz with 1.3g/t Au. Going forward, six exploration prospects (Hajeej, Sheers, Jadmah, Gossan-14, Waqba and Sha'abat Al Hamra), situated within a 30km area of Al Hajar, hold potential to increase ore reserves and gold production.

Sukhaybarat: Located in the Madinah province, Sukhaybarat is an ancient mine that commenced operations in 1991. Sukhaybarat is a closed open-pit mine, which ceased production in 2004, owing to depletion of ore reserves. However, a processing plant at the mine site with a capacity of 600ktpa is used to process ore transported from the nearby Bulghah mine and is expected to remain operational until 2014. The total reserves at Sukhaybarat mine consist of 2koz of gold with 0.4g/t Au. Due to the low level of grades, Sukhaybarat cannot profitably mine gold below the price level of USD600 per oz.

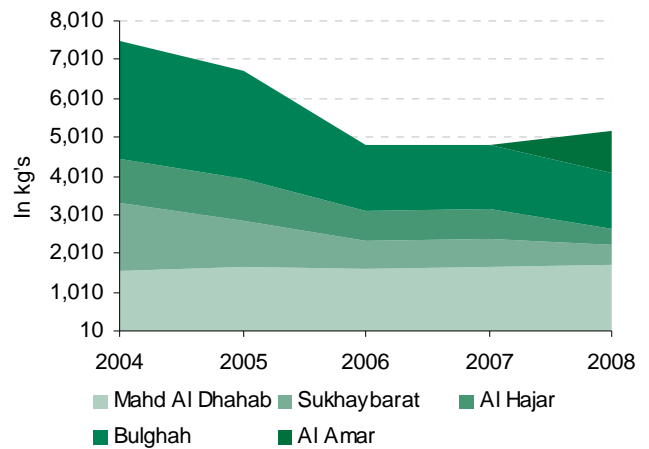
Source: Ma'aden

Figure 16: Location of operating mines in KSA



Source: Ma'aden

Figure 17: Mine-level gold production: 2004-2008



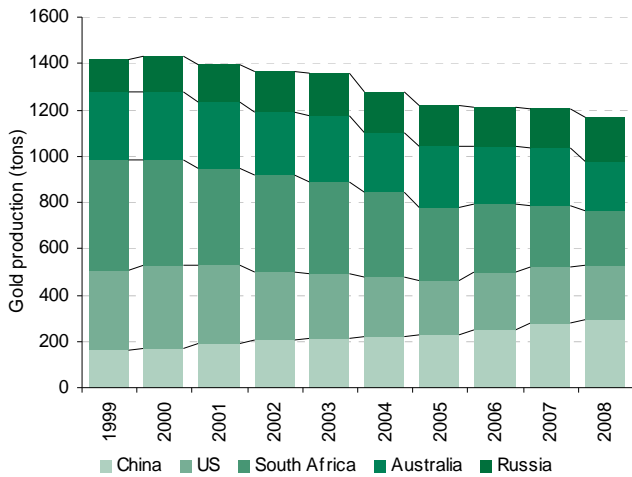
Source: Ma'aden

Untapped reserves hold potential for a turnaround

KSA's gold mining sector is at a nascent stage, with major portion of the country's reserves still untapped, highlighting the significant growth potential when other gold mining regions in the world are maturing

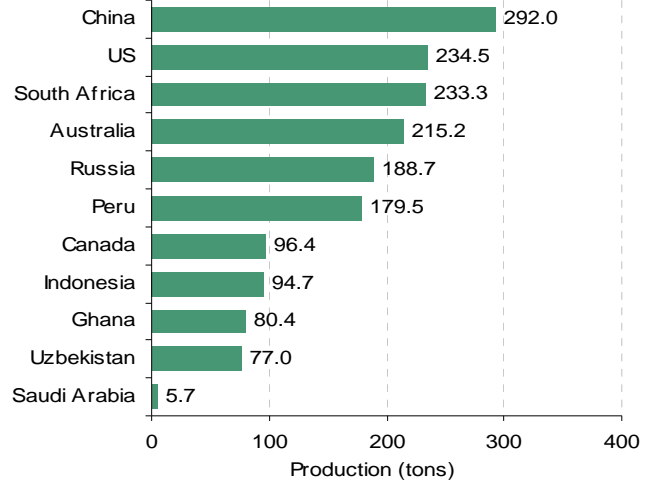
Although much of the mineral resource base of the country has not been systematically explored, Saudi Arabia is generally thought to possess substantial potential for gold mining. The Kingdom had estimated gold resources of some 10mn ounces (284 tons) as of November 2007, of which only a fifth is currently exploited. Moreover, the aggregate estimate is expected to grow as exploratory activities progress. However, little of this potential has materialized to date. Saudi Arabian production has been relatively modest by global standards and, moreover, has struggled to maintain a positive momentum. The total Saudi mining gold production in 2008 amounted to 5.7 tons, compared with global output of 2,407 tons. New investment plans in various exploration and advanced exploration properties are expected to materially improve this situation before long. The potential of Saudi Arabia as a gold producer is of considerable global importance and interest, given the continuous decline in production in gold producing nations.

Figure 18: Decreasing gold production of top four nations



Source: GFMS

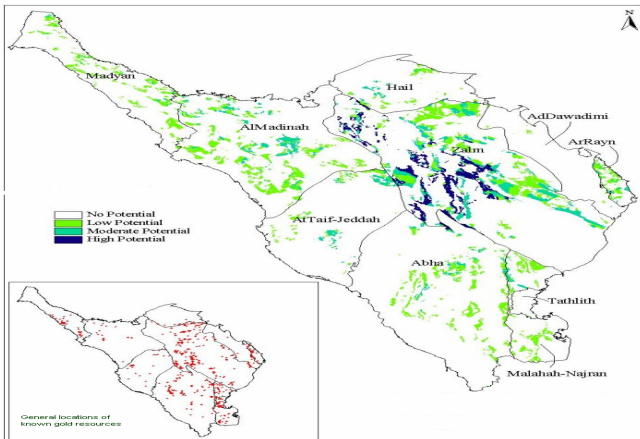
Figure 19: Gold production: Top 10 countries and KSA in 2008



Source: GFMS

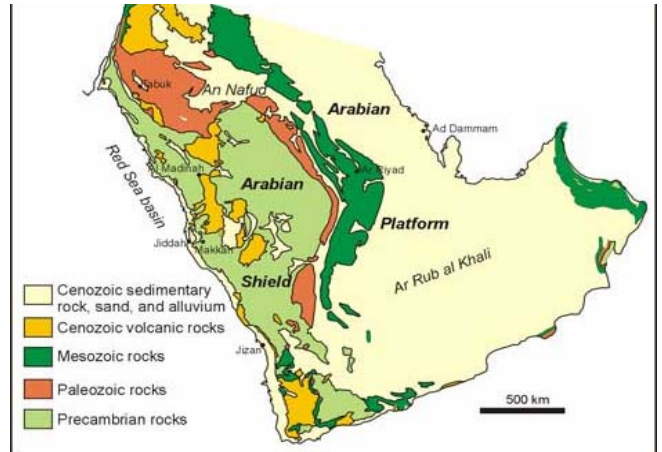
The Directorate General of Mineral Resources (DGMR) undertook the first major gold mining project in KSA in the 1970s, which led to the (re)discovery of the Mahd Al Dhahab ('Cradle of Gold') area. All subsequent deposits have been discovered in the same general area, all of them in the precambrian rock formations of the Arabian Shield in the west of the country. However, similar geology is abundant over a much large area along the Red Sea coast and in parts of central Saudi Arabia. This is a key factor behind the optimism regarding the Kingdom's potential. According to research conducted by exploration geologists Abdulrahman Shujoon and Douglas Pride of Ohio State University, of a total territory of 260,000 sq miles, some 5,000 sq miles could potentially have gold deposits and another 300 sq miles are deemed attractive for silver resources. The authors used global information system software to identify attractive prospects on the basis of the age of the rock, the shape of the terrain, and the location of key mineral deposits in a given area.

Figure 20: Possible gold deposit locations in KSA



Source: Ohio State University

Figure 21: Geology of KSA



Source: SGS

KSA holds an estimated 10mn ounces of total gold reserves from its operating mines and at the advanced exploration stage

Currently, 38 licensed gold exploration properties are located in the Central Arabian Gold (CAG) and the Northern Arabian Shield (NAS) region in KSA, all of them owned by Ma'aden. The CAG region consists of 17 exploration assets including five advanced exploration properties (AEPs) and 12 exploration properties (EPs). AEPs are areas whose resources have been defined, while EPs include exploration assets (both AEPs and EPs) within an exploration license. The

Northern Arabian Shield regions comprise 21 assets at the exploration stage. Apart from Ma'aden, Citadel Resources Group Limited, an emerging Australian mining company that focuses on the production of gold and base metals, owns two gold prospects. Citadel is listed on the Australian Stock Exchange (ASX: CGG).

Table 2: Total mineral resources of operating and advanced exploration mines in KSA (volume)

Mines	Grade (g/t Au)	Content (koz Au)
Operating mines		
Mahd Al Dhahab	16.1	643
Al Amar	11.2	722
Bulghah	0.80	617
Sukhaybarat	0.40	2
Al Hajar	1.30	87
Total resources	N/A	2,071
Advanced exploration properties		
Measured + indicated + inferred resources		
Al Duwayhi	3.9	2,116
Mansourah	2.3	1,616
Al Rjum	1.9	2,225
Masarrah	2.2	1,157
Al Suk	4.1	228
Zalim	1.7	590
Total mineral resources of advanced exploration mines	2.4	7,933
Total mineral resources of operating mines		2,071
Total mineral resources		10,004

Source: Ma'aden

The total known gold resources from the five mines that are currently operational (all of them owned by Ma'aden) and other mines that are at an advanced exploration stage are worth USD6.35bn, based on average gold price of USD872.0 per oz as of end 2008.

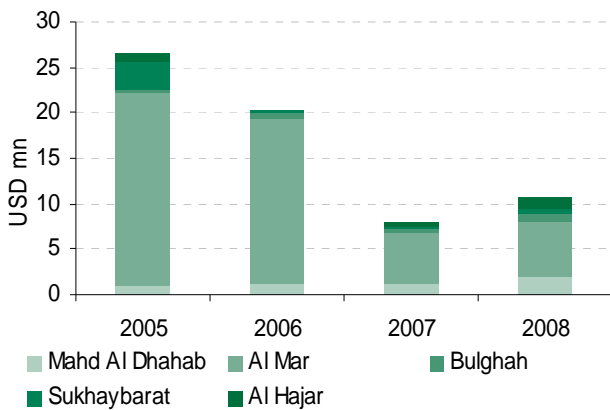
Table 3: Total mineral resources of operating and advanced exploration mines in KSA (value)

Mines	Operating/ start date	Content (koz Au)	Gold price scenarios and estimated value of resources (USD/oz and USD bn)		
			600	800	1000
Operating mines					
Mahd Al Dhahab	Operating	643	0.39	0.51	0.64
Al Amar	Operating	722	0.43	0.58	0.72
Bulghah	Operating	617	0.37	0.49	0.62
Sukhaybarat	Operating	2	0.00	0.00	0.00
Al Hajar	Operating	87	0.05	0.07	0.09
Total resources of operating mines		2,071	1.24	1.66	2.07
Advanced exploration properties					
Ad Duwayhi	2011	2,116	1.27	1.69	2.12
Mansourah	N/A	1,616	0.97	1.29	1.62
Ar Rjum	N/A	2,225	1.34	1.78	2.23
Masarrah	N/A	1,157	0.69	0.93	1.16
As Suk	N/A	228	0.14	0.18	0.23
Zalim	N/A	590	0.35	0.47	0.59
Total mineral resources of advanced exploration mines		7,933	4.76	6.35	7.93

Source: Ma'aden

With sustained and increasing capex plans of Ma'aden and the new entrants in the Saudi Arabian gold mining sector, the companies should further benefit from the generally favorable gold price outlook. Citadel Resources has completed its feasibility study on the Jabal Sayid project of Bariq Mining Limited (in which it holds a 50% stake). The mine is expected to commence gold production by 1Q-10. Citadel Resources is also conducting exploration and drilling in the Shayban gold project near Jeddah as well as in the Lahuf project located 12 kms from the Mahd Al Dhahab mine. Another prospect under exploration is Bari, located close to the Jabal Sayid project. In 4Q-09, Ma'aden plans to start developing the Al Suk gold mine, located in the west of the country.

Figure 22: Mine-specific capital expenditures on operating mines in KSA



Source: Ma'aden

Figure 23: Planned capital expenditure on operating mines (AEPs and EPs)

Mine	Capex (USD mn)	Period	Operator
Mahd Al Dhahab	10.3	2007-2012	Ma'aden
Al Amar	19.4	2007-2014	Ma'aden
Bulghah	3.4	2007-2014	Ma'aden
Sukhaybarat	4.5	2007-2014	Ma'aden
Al Hajar	3	2007-2010	Ma'aden
EP's	105.4	N/A	Ma'aden
Jabal Sayid	13	N/A	Citadel

Source: Ma'aden

With production from the mature mines declining, Ma'aden has prioritized new facilities as a focus of its capex. As much as 78.5% (USD124.8mn) of Ma'aden's total planned capex on gold (USD146mn) during 2007-2014 is directed to the development of its newest Al Amar mine and other exploration properties (Figure 23). Apart from expenditures on operating mines, various exploration activities are being conducted on advanced exploration and exploration properties across the Arabian Peninsula.

Table 4: Capex planned for Central Arabian Gold and Northern Arabian Shield regions

Region	AEPs (No's.)	EPs (No's.)	Capital expenditures (USD mn)					Last five year capex
			2004	2005	2006	2007	2008	
Central Arabian Gold region	5	12	6.04	7.03	6.36	6.6	4.23	30.26
Northern Arabian Shield region	0	21	0.46	0.99	2.33	1.95	4.97	10.7
Other regions	0	0	0.59	0.01	0.02	0.0	0.0	0.62

Source: Ma'aden

Regional advantages and challenges

Cheap energy, but access to water a key obstacle

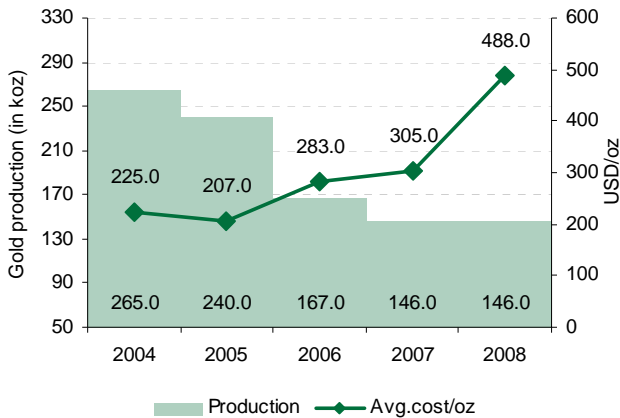
Cheap energy provide Saudi Arabian gold miners a significant competitive advantage, but the scarcity of water is a major problem

In spite of a key competitive advantage in the form of globally low energy costs, the overall average cash cost² of mining per ounce of gold in Saudi Arabia has been increasing in recent years. While declining ore grades have adversely affected production volumes, a lower stripping ratio in Saudi Arabia's ageing mines has rapidly pushed up the cost of mining in recent years. This has effectively eliminated the country's previous cost advantage vis-à-vis its global peers. In 2008, the average cash cost² of production per ounce of gold in Saudi Arabia -- approximately USD488.0 per oz -- was almost equal to the global average of USD489.8 per oz.

However, the Saudi cost profile may once again improve as new mines are brought into operation. International average cash costs per oz are expected to remain high with declining production volumes. However, the untapped resource base of 7.9 mn ounces of gold in Saudi Arabia is estimated to have a fairly highly average ore grade of 2.4g/t. This is far ahead of the situation in some of the existing mines such as Bulghah (0.80 g/t), Sukhaybarat (0.40 g/t) and Al Hajar (1.30 g/t). A feasibility study by Citadel Resources Group for the Jabal Sayid copper and gold project in Saudi Arabia points to a competitive cash cost of around USD330 per oz of gold.

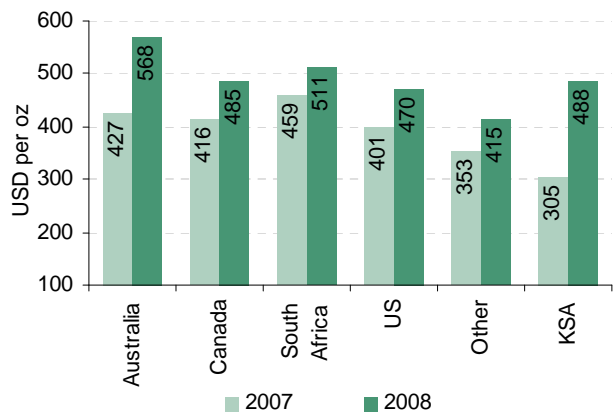
Apart from managing costs, a key pre-requisite for an existing or new mining project is the availability of necessary infrastructure. An important problem facing miners in Saudi Arabia is ensuring adequate supply of water and access to proper transportation infrastructure. In the absence of such requisites, the country's energy cost advantage can be quickly eroded. This risk tends to be exacerbated in the event of small and scattered deposits and low gold content ore, which is likely to be the case with at least some of the Kingdom's reserve base. For example, Ma'aden is facing difficulties in supplying adequate water to its Al Duwayhi mine. In the event of water from a local well being insufficient, the alternative is a costly 500 km pipeline from the city of Ta'if. A possible solution is the pooling and sharing of key facilities among adjacent mines, provided the clusters are large enough to make this economically viable.

Figure 24: Gold mining production and average cash cost² in KSA



Source: Ma'aden, NCBC Research

Figure 25: Average cash costs²: KSA vs. other gold mining nations



Source: GFMS, Ma'aden, NCBC Research

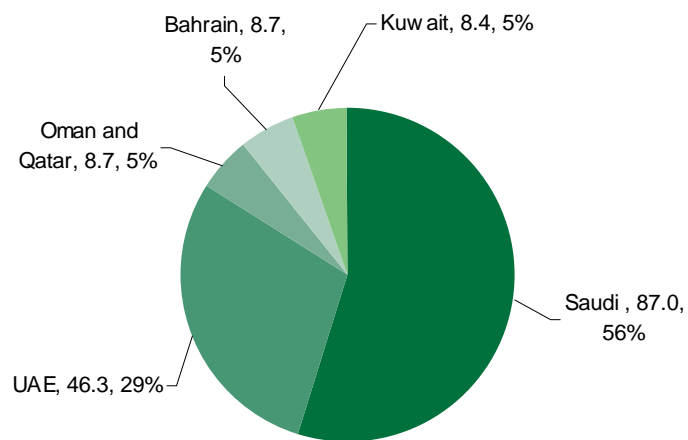
² Capital expenditure spent per oz of mined gold

GCC gold manufacturing and wholesale

Opportunities for regional expansion

The GCC gold jewelry manufacturers have acquired a global reputation for quality and craftsmanship due to their long history of design and manufacturing. Today, the region's overall estimated production is 159 tons. With an annual output of 87 tons, Saudi Arabia is the largest gold manufacturer in the region. Regional manufacturers design and produce more than 10,000 models per year across different product categories (sets, bracelets, and bangles) and gold karats (21k and 18k) often matching or even beating other global gold jewelry centers such as Italy, Singapore, and the US.

Figure 26: Gold jewelry production in the GCC in 2008 (tons/percentage of total GCC)



Source: GFMS

Profiles of top Saudi gold jewelry manufacturers

Table 5: Top gold jewelry manufacturers - KSA

Name of the company	Established	Headquarters	Manufacturing facilities	Production Capacity (tons per annum)
L'Azurde Group	1982	Riyadh	2	30
Saudi Gold Company	1978	Riyadh	1	18
Taiba for Gold and Jewels Co	1980	Jeddah	4	18
Musalli Factory for Gold and Jewelry	1986	Jeddah	4	24
Al Zaree Factory for Jewelry	1960	Riyadh	1	2

Source: Company websites, Zawya, NCBC Research

L'Azurde Group

L'Azurde Group, headquartered in Riyadh, was established in 1982. The company is primarily engaged in the manufacture, design, and distribution of gold and jewelry. The company established its first manufacturing unit in 1987 and operates two manufacturing facilities in Riyadh and Cairo. The company's current annual production capacity stands at 30 tons of jewelry per year. L'Azurde Group has a distribution network of 6 representative offices and 15

retail showrooms catering to an estimated 4,000 retail customers. With the exception of one wholesale facility and two retail showrooms in the UAE, L'Azurde is based in Saudi Arabia. The company's current workforce totals more than 2,200 employees. A private equity consortium composed of Investcorp, Eastgate Capital and the National Investor acquired 70% stake in L'Azurde in March 2009.

Saudi Gold Company

The Saudi Gold Company, based in Riyadh, was incorporated in 1978. The company's business activities include the refining and manufacturing of gold bars, coins, chains and other jewelry. The company has established its only manufacturing site at the Riyadh Second Industrial City, spanning over 14,000 square meters. The current annual total production capacity of the company stands at 18 tons of gold and it manufactures 2.5mn pieces of jewelry per year. The company specializes in manufacturing coins and ingots. The Saudi Gold Company distributes its output through a network of 12 showrooms — nine in Saudi Arabia, one in the UAE and two in the US.

Taiba for Gold and Jewels Co.

Taiba for Gold and Jewels Co. (Taiba), incorporated in 1980, is headquartered in Jeddah. The company is principally engaged in designing, manufacturing and marketing of gold jewelry with an emphasis on 21 and 18 karat gold. Taiba currently produces 18 tons of gold jewelry per annum through its four manufacturing facilities which are located in Egypt, Saudi Arabia, Syria and the UAE. Taiba operates a distribution network of 11 retail outlets, 8 of which are located in Saudi Arabia and one each in Lebanon, Syria and Turkey. The Company has also set up 3 wholesale showrooms, one each at Saudi Arabia, Syria and the UAE.

Musalli Factory for Gold and Jewelry

The Musalli Factory for Gold and Jewelry is headquartered in Jeddah. The company, established in 1986, specializes in the design, manufacturing and marketing of gold jewelry. The company's current annual production capacity is 24 tons of gold, which it produces through four manufacturing facilities in Saudi Arabia. Musalli primarily operates in Saudi Arabia through a network of six retail outlets, one each at Dammam, Jeddah, Madinah, Makkah, Khamis and Riyadh. In addition, Musalli has established one retail outlet in Dubai. The company had 75 employees as of June 2008.

Al Zaree Factory for Jewelry

The Al Zaree factory for Jewelry (Zaree) is headquartered in Riyadh. Established in 1960, Zaree is engaged in the manufacturing and distribution of fashion jewelry. The company currently produces two tons of jewelry per annum through its manufacturing facility spread over an area of 5,000 sqm. Zaree specializes in the production of 18 karat and 21 karat gold sets, made from both white and yellow gold, and employ 400 skilled workers.

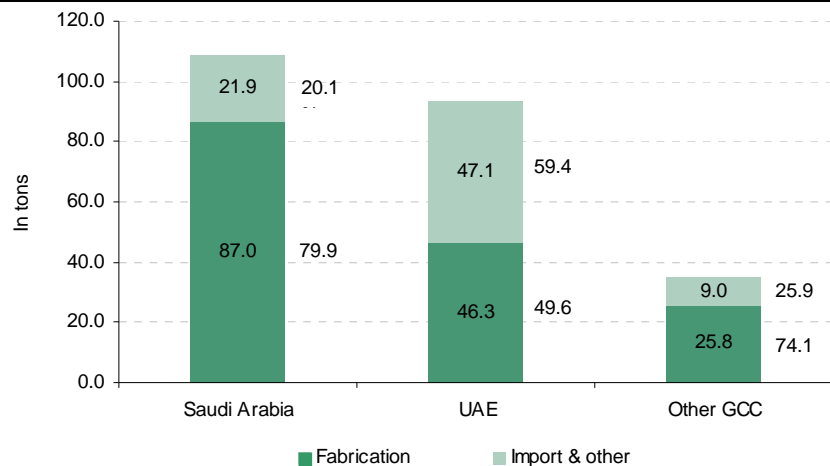
Opportunities in local and regional markets

Despite the impressive track record of local producers, 35% of the gold jewelry sold in the GCC was still imported as finished products in 2008, partly due to preference of niche consumer segments for branded products from specific countries such as Italy and because of the unavailability of new and complex jewelry designs from local manufacturers.

GCC gold jewelry manufacturers have significant expansion potential through import substitution and export to the large regional markets

Apart from opportunities created by import substitution, greater exports to neighboring countries offer GCC manufacturers a profitable avenue for leveraging their strong reputation for quality. Similarities in consumer tastes across the Middle East, design capabilities allowing for specific target market customization, and an increasingly borderless media reach would boost such a strategy. The gold jewelry market in the broader Middle East region³ and other neighboring markets such as Turkey amount to an estimated 380 tons per year. During 2002–2008, demand for gold jewelry fabrication (including the use of scrap) in the Middle East increased at 1.7% CAGR to 380.5 tons.

Figure 27: GCC local gold jewelry fabrication (including scrap) and imports in 2008 (volume/percentage)



Source: GFMS; Note: Saudi Arabia include figures for Yemen

Considerable strides have been made to realize this potential. Today, the UAE and Dubai in particular already constitute a regional hub for gold trade despite a small manufacturing base. In 1H-09, Dubai imported 300 tons of gold, a 13% increase over 265 tons during the same period of 2008. This show of strength builds on Dubai’s historical position as a gold trade hub; Dubai has also benefited from targeted government-led efforts to strengthen the Emirate’s role beyond import-export trade of physical gold and gold jewelry. For example, the Dubai Government established the Dubai Multi Commodities Center (DMCC) and the affiliated Dubai Gold and Commodities Exchange (DGCX) in 2002 and 2005 respectively. These bodies offer a range of products facilitating precious metals trading. DMCC also serves as a free zone for gold manufacturing while DGCX offers gold futures. Similar ventures are under consideration elsewhere in the region, which will provide a base for gold trading and export to neighboring markets.

³ Defined here to include the GCC countries, Yemen, Egypt, Iran, Iraq, Syria, Palestine, Lebanon and Jordan

A vibrant jewelry retail market

The GCC region is one of the most important gold retail markets in the world. However, the market, especially in Saudi Arabia, remains highly fragmented and economic pressures are likely to result in increased consolidation

Characterized by the highest gold consumption rates per capita, the GCC represents one of the most important retail markets for gold jewelry in the world. The region is home to approximately 8,000–10,000 gold jewelry retailers, a majority of them are based in Saudi Arabia and the UAE. Saudi Arabia has an estimated 5,000 retailers in a highly fragmented market where the top five players currently account for less than 5% of the total retail outlets. Considerable room therefore exists for consolidation. Most retailers are concentrated in main city streets and shopping centers and they primarily cater to the local population as well as, to a lesser extent, religious tourists visiting during Hajj and Omra pilgrimage seasons. The Saudi gold jewelry retail sector is currently estimated to employ over 12,000 people. Practically, all of them are nationals following the implementation of full Saudization in 2005.

The UAE is home to an estimated 1,500–2,000 jewelry retailers mainly located in Dubai. Most retail outlets are concentrated in gold souks and shopping malls where their clientele is primarily made up of the local expatriate population and tourists. The UAE gold jewelry retail market is relatively less fragmented than the Saudi market, with the combined market share of the top three players currently standing at 35%.

Significantly further consolidation among the regional gold retailers is highly likely. The recent economic downturn and increase in gold prices have challenged the smaller companies through weaker demand and higher working capital requirements. The increasingly common regional practice of providing credit facilities to consumers accentuates the working capital problem.

Company profiles: Gold and diamond jewelry retailers

Table 6: Retail - KSA

Name of the company	Established	Headquarters	Manufacturing facilities	Total retail Outlets	Retail stores in KSA	No. of Employees
Al Romaizan for Gold and Jewelry	1986	Riyadh	N/A	200-250	170-200	Over 300
Damas – KSA	2005	N/A	N/A	35	35	N/A
Ghassan Gold and Jewelry	1985	Dammam	2	19	19	Over 1,000

Table 7: Retail - UAE

Name of the company	Established	Headquarters	Manufacturing facilities	Total retail Outlets	Retail stores in UAE	No. of Employees
Damas Jewelry	1907	Dubai	9 (of which 8 are small size facilities)	450	239	2,000
Pure Gold Jewelers	1989	Dubai	N/A	75	61	350
Joyalukkas Holdings	1987	Dubai	N/A	76	38	150

Source: Company websites, Zawya, NCBC Research

Top Saudi Retailers

Al Romaizan for Gold and Jewelry

Established in 1986, Al Romaizan for Gold and Jewellery (Al Romaizan) is headquartered in Riyadh. The company is primarily engaged in the operation of gold jewelry retail outlets. Al Romaizan currently operates through three retail networks based in Dubai, Oman and Saudi Arabia, respectively. As of June 2008, the company had more than 300 employees.

Damas - KSA

In 2005, the UAE-based Damas entered the Saudi market through an AED250mn joint venture with the Saudi company Amwal Al Khaleej. Damas KSA currently operates through a network of 35 retail outlets in Saudi Arabia.

Ghassan Gold and Jewelry

The establishment of Ghassan Gold and Jewelry (Ghassan) goes back to 1885. However, the formal establishment of the company, headquartered in Dammam, took place in 1985. The company is engaged in the manufacturing, design, and distribution of gold and diamond jewelry. Ghassan operates two manufacturing facilities in Dammam. In addition, the company has a network of 19 gold jewelry outlets in KSA, as well as wholesale offices in Dammam, Jeddah and Dubai.

Fitaihi Group Holding Company

A diversified retailer of luxury products, the Fitaihi Group (originally Ahmad Hassan Fitaihi and Company) was set up in Jeddah in 1992. It was publicly listed on Tadawul in October 2005. Fitaihi has 16 showrooms in Saudi Arabia and one in Switzerland. It distributes a wide range of products but includes gold design and manufacture of gold jewelry among its range of activities.

Top UAE Retailers

Damas Jewelry

Established in 1907, Damas Jewelry (Damas), is headquartered and runs its largest manufacturing facility in Dubai. Damas is an integrated jewelry and watch retailing company. The company operates through a network of around 450 stores across 18 countries. Damas' retail network further includes retail outlets operated by subsidiaries in the Middle East, India, and North Africa. Of the total number of retail outlets, some 239 are spread across the UAE. Damas specializes in designing and retailing of 22-karat jewelry, which it markets through purpose-built showrooms. As of April 2008, the company had more than 2,000 employees. Damas International was listed on Nasdaq Dubai in July 2008.

Pure Gold Jewelers

Established in 1989, Pure Gold Jewelers (Pure Gold) is headquartered in Dubai. The company is engaged in the manufacturing, design, and retailing of gold and diamond jewelry products across the Gulf region and in India. Pure Gold has established a network of 75 retail outlets in the Gulf region of which 61 are located in Saudi Arabia and 22 are located in Dubai. The company manufactures and sources gold and diamond jewelry products from its manufacturing facilities in Mumbai, India. The company has staff of 350 and specializes in manufacturing diamond and pearl rings.

Joyalukkas Holdings

Joyalukkas Holdings (Joyalukkas), headquartered in Dubai was established in 1987. The company is engaged in the manufacture and distribution of jewelry and eye glasses. Joyalukkas has a network of 76 retail outlets spread over 9 countries including all six GCC countries. 38 of the showrooms are based in the UAE, 22 in India, five in Oman, four in Bahrain, three in Kuwait, two in Qatar, and one each in Saudi Arabia and United Kingdom. The company had 150 employees as of August 2008.

Short-term gold price outlook

Over the past two years, global demand for gold increased at a CAGR of 5.8% to 3,804 tons in 2008 while supply contracted by 1.0% to 3,512 tons. This has resulted in a sharp increase in prices

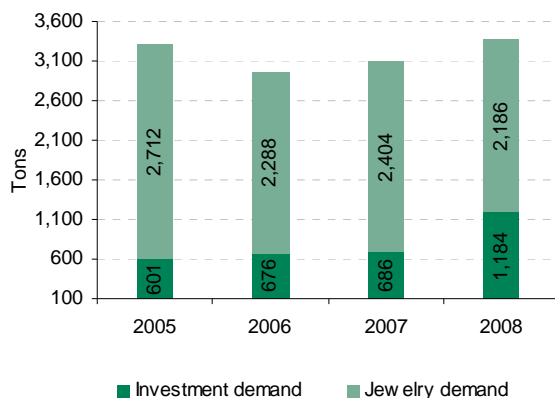
Global gold prices have remained on a fairly consistent strong upward trend since 2001, tripling from USD272.7 per ounce in 2001 to USD872 in 2008. Prices reached a peak of USD1,034 per oz in March 2008 and once again breached the USD1,000 per ounce mark in September. Gold currently trades at a narrow range of USD1,000–1,070 per ounce. Expectations of US Dollar inflation and elevated economic uncertainty in the face of an increasingly tight demand-supply balance are key factors behind the upward trend. Although continued volatility is likely, the longer-term price outlook for gold is very favorable as a range of factors point to strong and growing demand against the backdrop of tight supply.

Investment demand the key driver of recent market growth

In both 2007 and 2008, total gold demand outstripped the annual aggregate supply. Although a large part of the demand was linked to gold jewelry, the incremental growth was primarily driven by investment considerations. This was motivated by mounting anxiety about the economic situation following the onset of the credit crunch in late summer of 2007.

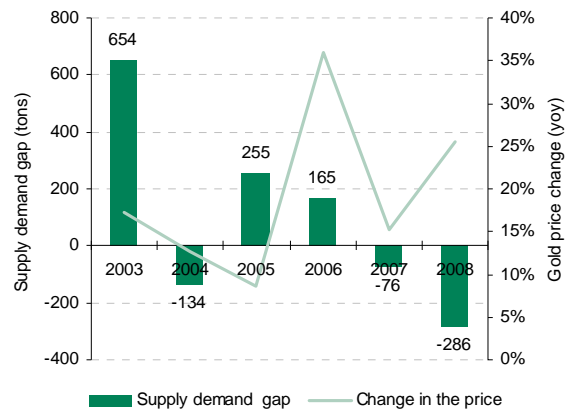
Following a relatively steady growth trend in previous years, global investment demand for gold almost doubled during 2007–2008, increasing from 686 tons to 1,184 tons.

Figure 28: Global investment demand⁴ and jewelry demand for gold



Source: WGC

Figure 29: Global gold supply⁵ and demand⁶ gap and gold price increase



Source: WGC

This upward trend has continued into 2009. A sustained reversal is unlikely as long as the outlook for sustained global economic recovery remains uncertain and the performance of other investment assets questionable or at least heavily reliant on the unusually loose monetary and fiscal policy stances adopted by governments and central banks globally.

In recent years, investment demand for gold has also benefited from product innovation that has made it easier especially for retail investors to place their savings in gold. With the emergence of non-physical gold investments, instruments such as exchange-traded funds (ETFs) have become increasingly popular, not only in gold but across asset classes. In addition to the convenience of not having to store physical gold, the instruments offer considerable advantages of liquidity and low management fees.

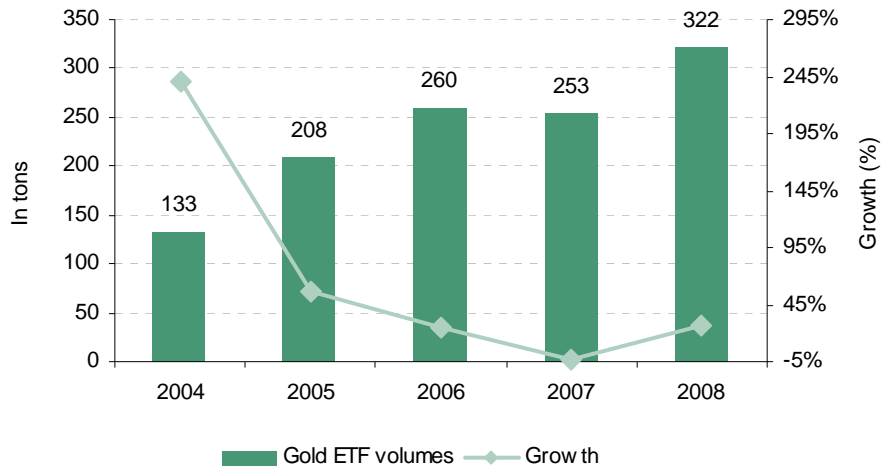
Increasing gold prices before the outbreak of the global financial crisis was due to higher demand for gold jewelry (wealth effect) and investment demand for gold

⁴ Investment demand includes net retail investment, ETFs and similar products

⁵ Total global supply includes global mine production (net of producer hedging), official sector sale and old gold scrap

⁶ Total global demand includes demand for fabrication, bars & coins, other retail investment and demand for ETFs and similar products

Figure 30: Growth of gold ETF volumes



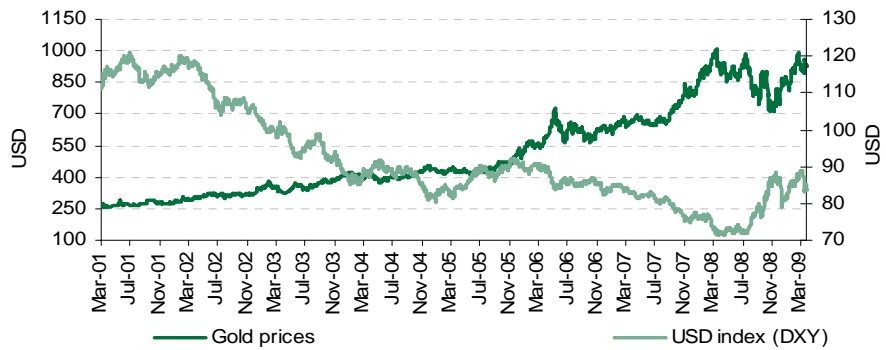
Source: WGC

Uncertain recovery prospects and fears of Dollar inflation support gold price

Continued economic uncertainty and expectations of US Dollar inflation are fueling investment demand for gold

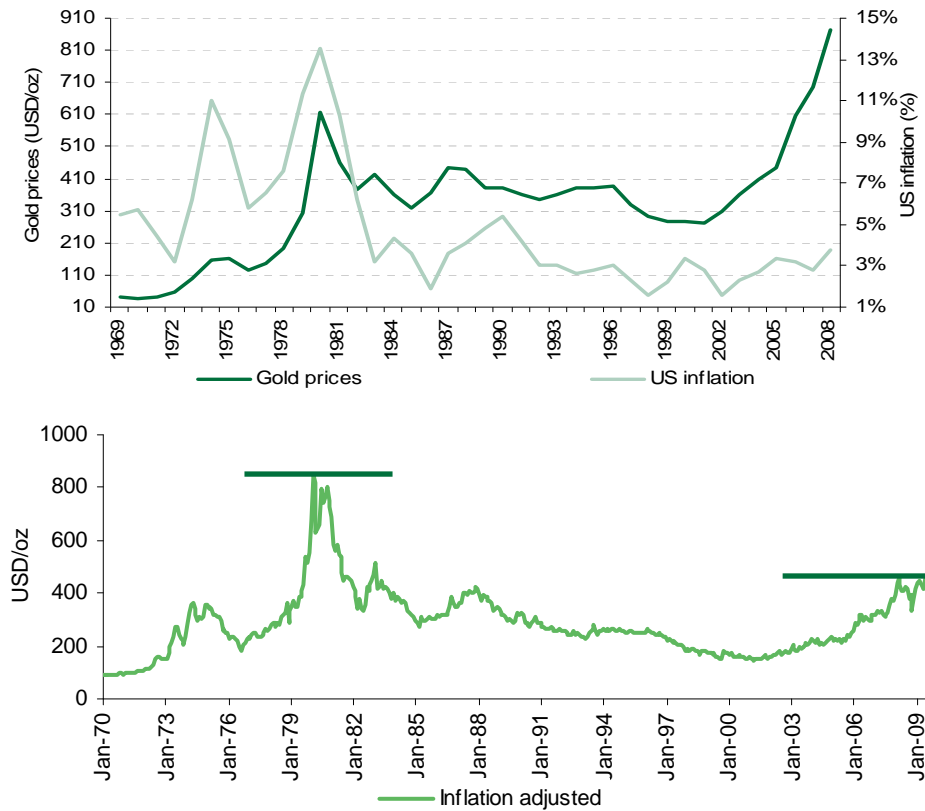
In recent years, the relationship between the US Dollar and gold prices has been characterized by strong and consistent negative correlation. Fears of Dollar depreciation due to mounting US government debt and inflationary pressures linked to the aggressive economic relief measures, most notably quantitative easing, underpin gold price strength. Recently, the US Dollar breached its one-year low mark against the Euro at USD1.4881. Since early 2009, the US Dollar has depreciated against other major currencies including the Japanese Yen, the British Pound and the Swiss Franc.

Figure 31: Gold prices vs. the US Dollar



Source: WGC, Bloomberg

Figure 32: Gold price vs. US inflation and inflation-adjusted gold prices (1970-2008)



Source: WGC, Bloomberg

Since gold is priced in US Dollars, it has traditionally benefited from Dollar weakness. This pattern temporarily broke down this year with gold and the Dollar both benefiting in similar ways from bouts of increased investor risk aversion due to their perceived safe-haven status. However, recent developments suggest that this altered relationship is unlikely to persist. Moreover, going forward, the substantial fiscal deficits and mounting public debt levels that major economies have amassed in an effort to fight the ongoing credit crisis may well create political incentives to boost inflation. These fears are heightened by the possibility of using inflation as a means of deleveraging after the rapid debt accumulation that materialized during the long period of low interest rates during much of the past decade.

Higher gold prices are supported by inflationary fears, stoked by the huge economic stimulus packages around the world

Regardless of the intentions of policymakers, inflationary pressures may materialize if the aggressive stimulus measures are not phased out in a timely manner. Although US inflation declined to a low 0.4% in August 2009, the Federal Reserve's massive quantitative easing effort and negative real interest rates continue to fuel fears that inflation might soon reassert itself. Under the circumstances, while the Dollar may benefit from its global reserve currency status and the relative absence of credible alternatives, it may well be tested by periods of heightened investor anxiety, which should once again favor gold. This scenario is most likely to be avoided if the US economy sustainably stabilizes in a way that permits a timely return to fiscal normalcy.

The tendency of investors to hold gold as a hedge against economic and political uncertainty was amply in evidence during the period of elevated inflation in the 1970s. The US government's decision to abandon the Bretton Woods exchange rate system in 1971 severed the historical link between the US Dollar and gold. Inflation in the US increased from 5.7% in 1970 to about 13.5% in 1980 when the transition to fiat money was followed by the supply shock caused by the OPEC decision to increase oil prices. Accommodating government policy

quickly resulted in accelerating inflation. During the decade, gold prices increased dramatically at 52% CAGR from USD36.07 per oz in 1970 to USD614.6 in 1980. The trend was finally broken due to the determined anti-inflationary stance adopted by a number of countries in the 1980s. The second major bull run of the post-Bretton Woods era began in 2002 and has lasted seven years to date.

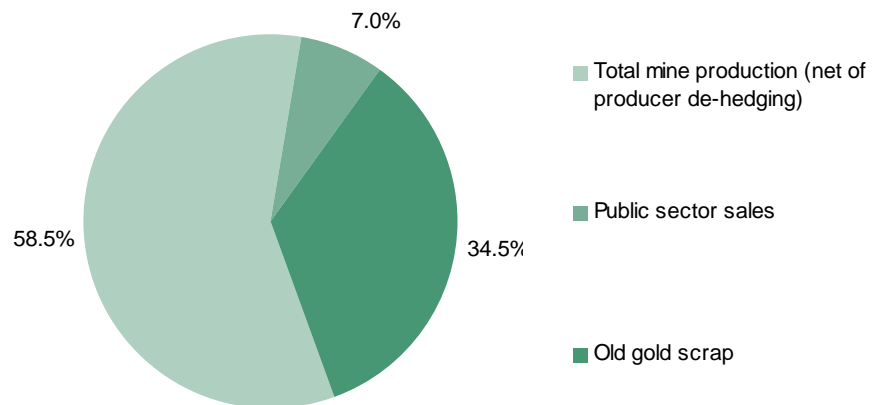
The post-Bretton Woods experience points to a clear inverse relationship between the gold prices and overall political commitment to macroeconomic stability. The advent to power of Margaret Thatcher and Ronald Reagan in 1979–1980 led to a sharp reversal in macroeconomic policy with low inflation prioritized over employment. It was ultimately attained through sharp economic downturns and substantial unemployment. Nonetheless, the monetarist orthodoxy largely restored investor confidence in the leading global currencies and reduced the relative attractiveness of gold.

Structural factors tighten gold supply despite increase in scrap sales

Maturing gold mines across the world reduced aggregate supply by about 4% in 2008, driving prices higher

In 2008, overall global gold supply was 3,512 tons. The main source of this was mining, although disposal of gold holdings by institutional investors such as central banks or hedge funds and private scrap gold sales were also significant contributors.

Figure 33: Global gold supply by origin: 2008



Source: WGC

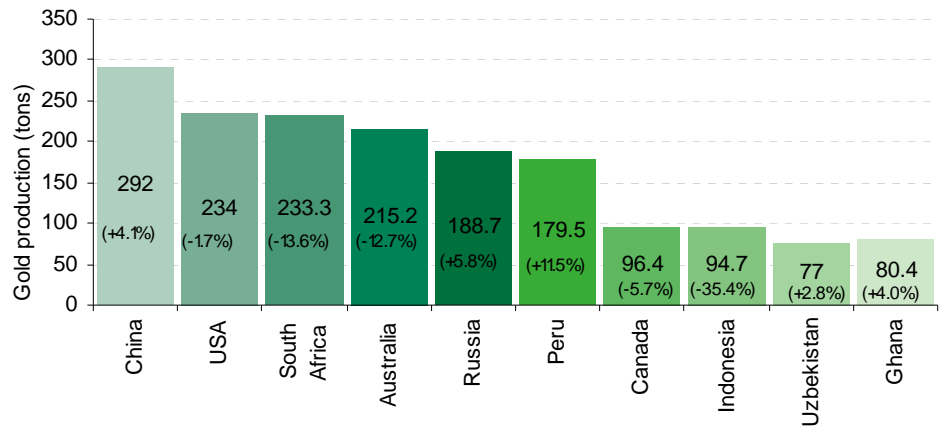
Overall, however, the global gold supply situation is showing signs of becoming tighter. In 2006–2008, total supply of gold from all sources, including mining output and sales by institutional and private investors, declined 1.0% to 3,512 tons from 3,582 tons. This contrasted with the demand increase of 5.8% over the same period to 3,804 tons and with historical supply growth.

This decline in global gold supply is attributable to a combination of factors: tightening of gold mine output, in turn a function of depleting reserves and tighter supply management by the miners; and a reduction in disposal of gold by the largest holding central banks, which recent decisions suggest will persist.

Mining supply

Gold supply from mining declined at 0.7% CAGR over the past three years. Most top mining countries and companies attribute their inability to meet demand to inevitably protracted lags in translating new capex and operational expansion of mines and related processing plants into actual supply increases. Limited increase in new explored reserves and steady depletion of existing ones is also often cited as a reason for tightening of supply. China, Peru and Russia are the only leading global producers that have not experienced production declines from their historical peak levels. No major mines are expected to commence operations in the near future and gold mining supply is expected to remain tight.

Figure 34: Production growth/declines of top producers (YoY in 2008)



Source: GFMS

Supply from institutional gold holders

Partly as a legacy of the Gold Standard, central banks are among leading repositories of gold globally with estimated aggregate holdings of 29,663 tons as of April 2009. This makes them a potentially important influence in the gold market. Around 60% of all gold stocks held by central banks worldwide are concentrated in five countries: the US, Germany, Italy, France and China. Central banks generally sell gold to rebalance their portfolios in favor of other asset classes that provide higher returns and greater liquidity. Some central banks disposed of large quantities of gold during 1990s and the earlier part of this decade as gold yields compared unfavorably with most other asset classes.

Central banks are increasing their gold stocks to diversify away from dollar-denominated reserves

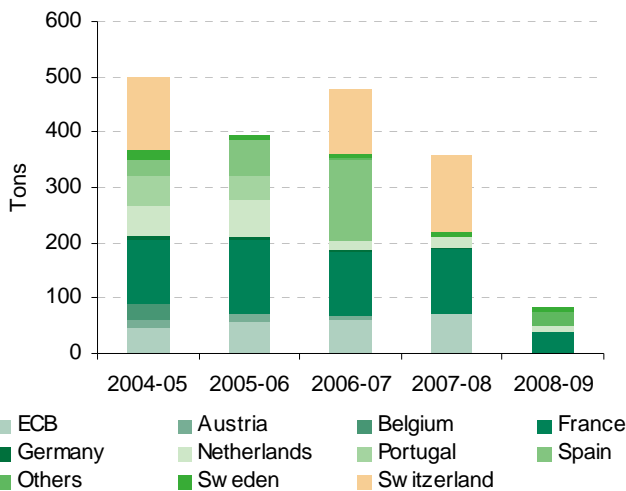
Given the size of the central bank gold holdings, any sudden substantial sale of stock will lead to severe price shocks in the markets. To avoid such a situation, in 1999, the European Central Bank (ECB) led 15 central banks in Europe (totaling 42% of global central bank gold holdings as of 2008) in signing the Central Bank Gold Agreement (CBGA) that capped maximum gold sale volumes by the signatories to around 400 tons a year for five years. The agreement was renewed in 2004 for five more years with annual gold sales capped at 500 tons. The CBGA is generally agreed to have significantly stabilized gold market prices. Concerns about implications of the agreement lapsing were overcome when, on 7 August 2009, CBGA announced the renewal of the agreement for the third time. The new CBGA (III) will begin on 27 September 2009, with an additional signatory; Slovakian National Bank. CBGA (III) limits gold sales to not more than 400 tons per year. The fact that there are few sellers in the market is evident from the lower sales limit set by the new CBGA agreement. Between September 2008 and end-July

2009 only 140 tons of gold were sold in the market. Moreover, after the new pact was signed, none of the signatories except the IMF are known to have shown interest in gold sales

The trend of gold disposals began to reverse as early as in 2005 and some central banks have sought to rebuild or increase their gold balances. The policy reversal was naturally driven by increasing gold prices and mounting fears about the outlook for the US Dollar at a time when the greenback remains the world's predominant reserve currency with an 62.8% share of the total as of 2Q-09. In 2008, aggregate gold sales by central banks declined a remarkable 42% from 484 tons sold in 2007, and the trend is expected to continue in 2009. The GFMS estimates net official sector sales for 1H-09 at 39 tons, down 73% YoY. It further estimates net sales to rise only moderately to 100 tons in 2H-09, resulting in annual total central bank sales of roughly 140 tons — the lowest number since the net official sales of 130 tons in 1994.

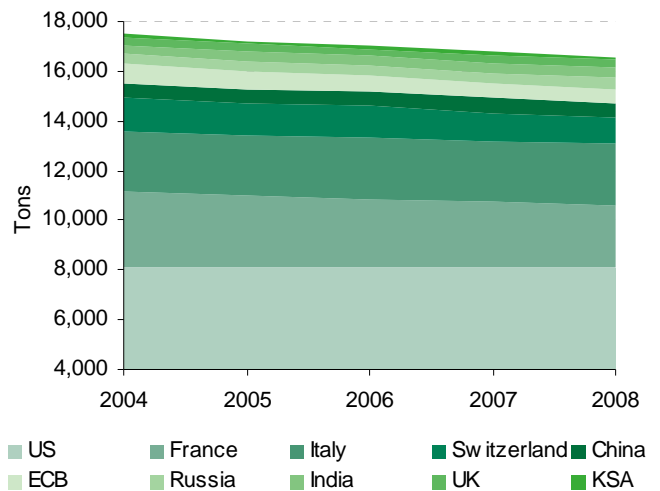
The interest in renewed gold purchases has been particularly evident in case of central banks of key emerging markets such as China and Russia, which are among the leading repositories of Dollar reserves in the world. The steps appear to be motivated mainly by a desire to gradually diversify these reserves away from the US Dollar, not least because these steps have been accompanied by increasingly frequent and vocal criticisms on the current role of the Dollar and the policy stance of the US authorities. China, in particular, has led the calls for a new international reserve currency with People's Bank of China speaking favorably about an arrangement akin to the Bancor idea put forward to John Maynard Keynes of the British delegation at the Bretton Woods talks in 1944. The Bancor was to be an international currency whose value was to be determined by 30 commodities, including gold. This recognition, in part, is likely to have motivated the decision to build reserves in a number of commodities, not only gold. The practical challenges of such a reform are considerable and even Chinese officials have openly admitted that a near-term solution is unlikely. Nonetheless, there are growing indications that a gradual departure from the post-Bretton Woods order may be underway, supporting greater monetary conservatism that might lead at least individual economies to consider arrangements more akin to the Gold Standard. This should boost physical demand for gold and reduce the probability of major economic crises and protracted inflation.

Figure 35: Annual gold sales by European central banks



Source: WGC

Figure 36: Gold stocks of central banks in tons

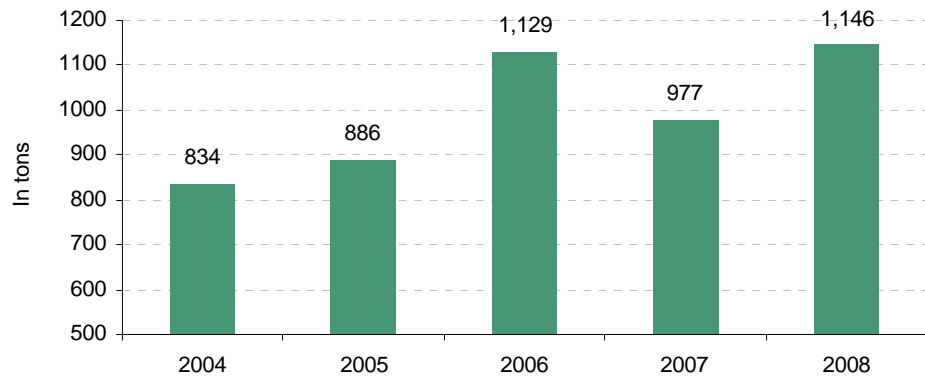


Source: WGC

Scrap gold

The sale of scrap gold in the form of coins, bullion or jewelry tends to be closely linked to price levels and the outlook, but also to the liquidity situation of both institutional investors and households. The upward trend in gold prices against a backdrop of an economic crisis explains the significant increase in scrap gold sales since 2006. Indeed, 2008 — the peak year to date — saw an unprecedented combination of record high gold prices and exceptional deterioration in the value of personal savings and investor returns.

Figure 37: Volume of scrap sales in past five years



Source: WGC

Total scrap sales in 2008 amounted to 1,146 tons, up 3.7% from the average of the previous four years. In fact, some traditional net gold importers such as India, China and Turkey have recently seen periods of net exports. While this increase in scrap sales has helped alleviate the previous supply constraints in the gold market, it is unlikely to fully counter the decline in mining and institutional gold supply. Moreover, the sustainability of the recent increase in scrap sales remains unclear in view of the exceptional uncertainty regarding the nature and duration of the current downturn, the perceived gold price outlook, and the willingness of owners of gold to continue to dispose of their holdings (especially private jewelry, which will have emotional value and uses that make it less sensitive to price variations).

Price outlook estimates

The consensus view among industry analysts points to sustained high gold prices in the near term. Current estimates for 2009 range between USD700 per oz and USD1,300 per oz with an average of approximately USD900 per oz, a figure that appears somewhat low in view of recent developments. Little change to the situation is seen in 2010. Most observers expect the price to remain above USD1000 per oz and possibly even increase somewhat from its current level. The most bullish forecasts see gold advancing to USD2000 or even USD3000 an ounce, highlighting the unusual degree of uncertainty in the markets. While short-term corrections in the price remain a possibility, gold price should remain quite resilient in view of the strong structural drivers.

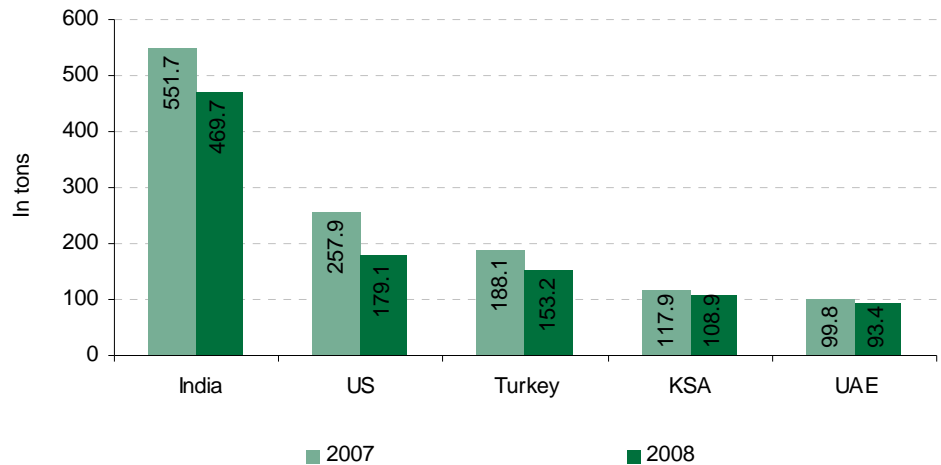
Although high prices will undermine demand, the GCC should remain fairly resilient

Over the past two years, gold prices have increased by 40%, but higher volatility has been evident. Price variations reached an all-time high in 2008. This, combined with a gloomy

In 2009, most commodity analysts expect gold prices to remain around the USD900 level amid the uncertainty and risk aversion caused by the financial crisis and expectations of US Dollar inflation

economic situation and outlook, led to a decline in demand in volume terms globally in 2008. The leading contributing factor was an 11% YoY drop in gold jewelry consumption to 2,137.5 tons. This outweighed the concurrent increase in investment demand. This continued a protracted downward trend that has been in evidence during the period of gold price appreciation. Overall, the gold jewelry market contracted at 3.7% CAGR in volume terms during 2002–2007 as prices expanded at 18.8% CAGR to USD872.0 per oz in 2008. The demand contraction was in evidence across virtually all the main gold markets.

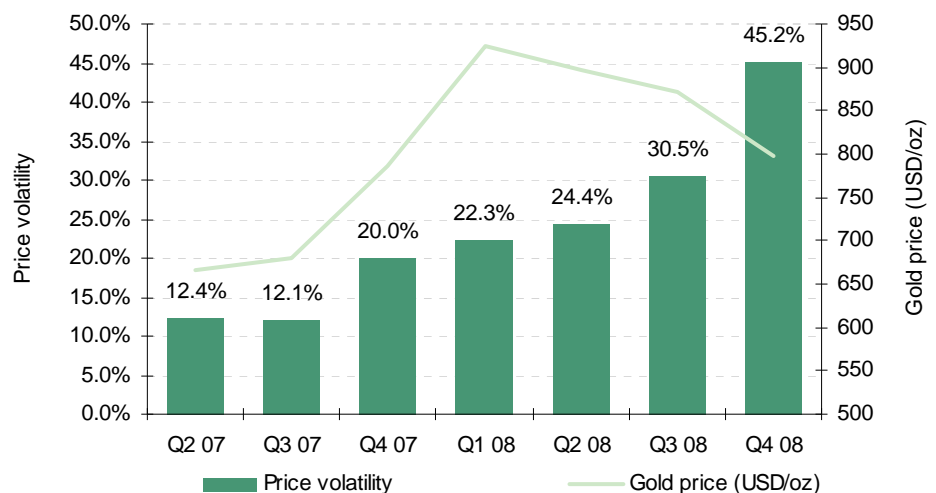
Figure 38: Declining jewelry demand in select leading markets



Source: WGC

The heightened gold price volatility especially since 2H-08 appears to have further tested the appetite of buyers and contributed to declining volumes. Global gold jewelry demand volumes decreased further by 37% in 1Q-09.

Figure 39: Gold price and volatility 2007 to 2008



Source: WGC

While the GCC was by no means immune to global trends, it has been a fairly resilient market by international standards, recording 21% decline in 1Q-09. In 2Q-09, driven mainly by the Saudi Arabian market, which grew by 87%, the GCC staged a remarkable recovery ahead of other global markets, growing 58% compared with a global average of 19%. Although YTD gold jewelry consumption in the GCC is still lower vis-à-vis the year-earlier period, solid demographic and macroeconomic fundamentals and the attachment of regional consumers to gold should



allow the GCC gold market to be one of the fastest to recover as gold prices stabilize and the world finds its way out of the crisis. The GCC markets should benefit from the relative strength of their economies, which are likely to record far smaller contractions this year than many Western markets. With an oil price recovery likely to be sustained, the markets should bounce back close to their trend growth rate in 2010.



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