

مصرف



A L S A L A M B A N K

البحرين Bahrain

Dynamic. Diversified. Differentiated.

ANNUAL REPORT 2006

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بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

« وَقُلْ أَعْمَلُوا فَسَيَرَى اللَّهُ عَمَلَكُمْ وَرَسُولُهُ وَالْمُؤْمِنُونَ »

(صدق الله العظيم)

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His Highness Shaikh  
**Khalifa Bin Salman Al Khalifa**  
The Prime Minister of the Kingdom of Bahrain



His Majesty King  
**Hamad Bin Isa Al Khalifa**  
The King of Bahrain



His Highness Shaikh  
**Salman Bin Hamad Al Khalifa**  
The Crown Prince and Commander-in-Chief of the  
Bahrain Defense Force

## Our Vision

To be a leading force in the Islamic financial services industry by providing a differentiated Shari'a-compliant offering to focused segments, building a reputation as a "Trusted Islamic Bank" and enhancing shareholder value.

## Our Mission

- To become a one-stop-shop for providing differentiated Islamic financial products to specific target segments.
- To build a strong global presence and premier brand image as an Islamic financial Shaper.
- To achieve high returns for investors and shareholders based upon defined risk appetites.

## AL SALAM BANK - BAHRAIN B.S.C.

Incorporated on 19 January 2006 in the Kingdom of Bahrain, with a paid-up capital of BD 120 million (US\$ 317 million), Al Salam Bank – Bahrain commenced commercial operations on 17 April 2006. The Bank operates under Islamic principles and in accordance with regulatory requirements for Islamic banks set by the Central Bank of Bahrain.

The Bank's Initial Public Offering, comprising 35 per cent of the paid-up capital, raised over BD 2.7 billion (US\$ 7 billion) and was the largest IPO in the Kingdom's history. The Bank was subsequently listed on the Bahrain Stock Exchange on 27 April 2006.

The founding shareholders of the Bank hold 65 per cent of the paid-up capital. They include leading regional institutions such as Emaar Properties, Amlak Finance, Dubai Holding, Dubai Investment Group, and Global Investment House, together with other strategic shareholders from across the Middle East.

The Bank is committed to adopting internationally recognised standards and best practice in critical areas such as corporate governance, compliance, legal, risk management and operations with the highest levels of integrity, transparency and trust.

Additionally the Bank is equally committed to its role as a concerned corporate citizen, actively seeking ways to contribute and add value to the social and economic well-being of the local communities in which it invests and operates.



### OPERATIONAL

- Established organisational capacity of the Bank
- Introduced strong corporate governance and risk management framework
- Recruited high calibre management team
- Implemented phase one of new core banking system
- Relocated to purpose-designed new premises
- Finalised preparations for launch of full banking operations
- Participated in establishment of a real estate development company in Bahrain
- Concluded a real estate deal in Malaysia
- Entered into a strategic private equity partnership in China

### FINANCIAL

Total operating income	BD 20,428,833 (US\$ 54,187,886)
Net profit	BD 16,418,792 (US\$ 43,551,172)
Return on average equity	15.1%
Earnings per share	151 fils
Total assets	BD 188,058,536 (US\$ 498,829,008)
Total equity	BD 136,401,589 (US\$ 361,807,928)
Cost-to-income ratio (operational efficiency)	19.6%





Top Row (R-L): Essam Al Muhaideb, Omar Mahmood Al-Quqa  
 Bottom row (R-L): Salem Rashed Saeed Al Mohannadi, Saleh Saeed Ahmed Lootah, Habib Ahmed Kassem,  
 H. E. Mohamed Ali Alabbar, Hussein Mohamed Salem Almeeza, Mohamed Omeir Bin Yousef .

**H. E. Mohamed Ali Alabbar - Chairman**

H.E. Mr. Mohammed Alabbar is currently leading many of the important institutions in the United Arab of Emirates and other countries. Mr. Alabbar is the Director General of the Department of Economic Development, Government of Dubai, which he helped to set up in 1992. H.E. Alabbar is the Chairman of Emaar Properties, Emaar Investments & Industries Company, Dubai Cable Company, Al Salam Bank - Sudan, Al Salam Bank - Algeria, and Leader Capital. He is also a Board member of Dubai Executive Council, Dubai Economic Council, Dubai Aluminium Company, UAE Stocks & Commodities Authority. He is also a founder of Dubai Financial Market. In addition, H.E. Alabbar is also the Chairman of the UAE Golf Association and the Rashid Pediatric Centre. He is also a founder member of the Arab Business Council, which was established by the World Economic Forum.

**Husein Mohamed Salem Almeeza - Vice Chairman and Managing Director**

Mr. Husein Mohamed Almeeza is the Vice Chairman and Managing Director of Al Salam Bank - Sudan & Al Salam Bank - Algeria and the Vice Chairman of Leader Capital; and the Vice Chairman and Managing Director of Dubai Islamic Insurance and Reinsurance Company. He is also a main founder of Dubai Islamic Bank and a Board member of Emaar Investments & Industries Company, Board member of Gulf Jet, and Committee member of Islamic Finance Advisory Council/ Dubai International Financial Centre. Prior to that, Mr. Husein Almeeza was Chairman of Emaar Financial Services Company, Board member and Chairman of the Executive Committee of Amlak Finance. He was also the Chairman of the Centre of Liquidity Management. In 2006, Mr. Almeeza was awarded the 'Islamic Banker of the Year 2006 award' at the World Islamic Banking Conference in the Kingdom of Bahrain, in recognition of his significant contribution to the Islamic banking and finance sector.

**Essam Al Muhaideb - Member**

Mr. Essam Al Muhaideb is Group Managing Director of A.K. Al Muhaideb & Sons; Managing Director and Board member of Al Muhaideb Foods Group; and President and Board member of Giant Stores and United Group Central Markets, which are all based in Saudi Arabia. Mr. Al Muhaideb is the Chairman of Bahrain Central Markets Company, and Vice Chairman of DNATA, Kuwait. He is also a Board member of Gulf Union Insurance Company, Mashaer Company (Kuwait), Nama Group (Qatar), Teeba Holding Company (Lebanon), Gef Holding Company (Switzerland), VeeTee Investment Corporation (UK), Al Massa International (Canada), and Reem Rice Mills Limited (Pakistan).

**Habib Ahmed Kassem - Member**

Mr. Habib Kassem has been a Member of the GCC Consultative Council for the Supreme Council since 1997. Mr. Kassem is the Chairman of Almahd Investment Company, Bahrain Ferro Alloys, Bahrain Electricity Supply & Transmission Company, Bahrain Import Export Company (Esterad), Capital Growth Management, and Quality Wire Products Company. He is also the Chairman of Almahd Day Boarding School.

**Mohamed Omeir Bin Yousef - Member**

Mr. Mohammed Omeir is currently the Chief Executive Officer of Omeir Bin Yousef Holding Group. Mr. Yousef is a Board member of Al Salam Bank - Sudan.

**Omar Mahmood Al-Quqa - Member**

Mr. Al-Quqa is a Chartered Financial Analyst (CFA), and a co-founder and Executive Vice President, Corporate Finance & Treasury, of Kuwait-based Global Investment House. Mr. Al-Quqa is the Chairman of Jordan Trade Facilities Company. His Vice Chairmanships include: Housing Finance Company (ISKAN) and Iraq Holding Company (both based in Kuwait); Arabian Seas Insurance Company (Jordan); and Bahrain-based Real Estate Finance Company (Reef). He is also a Board Member of the following companies: Al-Manar Finance & Ijara (Kuwait); Bahrain-based Khaleej Development Company (Tameer); United Finance Company (Oman); Baghdad Bank (Iraq); Al Salam Bank - Sudan; Investment Funds Company (Jordan); and the regional office of Palestine Public Real Estate Company in Jordan.

**Saleh Saeed Ahmed Lootah - Member**

Mr. Saleh Lootah is currently the Group Executive Director of the S.S. Lootah Group. Mr. Lootah is a Board member of Dubai Islamic Bank, Amlak Finance Company, and Dubai Insurance & Reinsurance Company. He is also a member of the Board of Trustees of Dubai Medical College.

**Salem Rashed Saeed Al Mohannadi - Member**

Mr. Salem Al Mohannadi is currently the Executive Director for Finance and Administration at Abu Dhabi Investment Authority, also a Board member of Emaar Properties, and Board member of Al Salam Bank - Sudan. Mr. Salem Al Mohannadi was also the Chairman of Tunisia Emirates Investment Bank.



#### Dr. Hussain Hamid Hassan - Chairman

Dr Hassan holds a Ph.D. from the Faculty of Shari'a, Al Azhar University, Cairo, Egypt; and a Masters in Comparative Jurisprudence and Diploma in Comparative Law (both of which are the equivalent of a Ph.D.) from the International Institute of Comparative Law, University of New York, USA. He also holds a Masters in Comparative Juris, and Diplomas in Shari'a and Private Law, from the University of Cairo; and an LL B in Shari'a from Al Azhar University. He is the Chairman and member of the Shari'a Supervisory Board in many of the Islamic Financial Institutions. In addition, Dr. Hassan is Chairman of the Assembly of Muslim Jurists, Washington, USA; a member of the European Islamic Board for Research & Consultation, Dublin, Ireland; and an Expert at the Union of Islamic Banks, Jeddah, Kingdom of Saudi Arabia.

#### Dr. Ali Mohuddin Al'Qurra Daghi - Member

Dr. Al'Qurra Daghi holds a Ph.D. in Shari'a and Law, and a Masters in Shari'a and Comparative Fiqh, from Al Azhar University, Cairo, Egypt. He also holds a BSc. in Islamic Shari'a from Baghdad University, Iraq; a certificate of traditional Islamic Studies under the guidance of eminent scholars in Iraq; and is a graduate of the Islamic Institute in Iraq. He is currently Professor of Jurisprudence in the faculty of Shari'a law and Islamic Studies at the University of Qatar. He sits on the Boards of Shari'a Supervisory Boards for several banks and financial institutions. Dr. Al'Qurra Daghi is also a member of the Islamic Fiqh Academy, the Organisation of Islamic Conference, the European Muslim Council for Efta and Researches, the International Union of Muslim Scholars, and the Academic Advisory Committee of the Islamic Studies Centre, Oxford University, UK. He also has published several research papers tackling various types of Islamic Finance, Islamic Fiqh, Zakah and Islamic Economy.

#### Shaikh Adnan Abdulla Al Qattan- Member

Shaikh Adnan Al-Qattan holds Masters degree in the Quran and Hadith from the University of Um Al-Qura, Makka, Kingdom of Saudi Arabia; and Bachelor's degree in Islamic Shari'a from the Islamic University, Madeena, Saudi Arabia. Shaikh Al Qattan is also a Judge in the Shari'a Supreme Court, Ministry of Justice – Kingdom of Bahrain. Shaikh Al Qattan is a Member of Shari'a Supervisory Boards for several Islamic banks and he is also Chairman of Al Sanabil Orphans Protection Society, Chairman of the Board of Trustees of the Royal Charity Establishment under the Royal Court – Kingdom of Bahrain, and President of the Kingdom of Bahrain Hajj Mission. In addition, he is a Friday sermon orator at Al-Fatih Grand Mosque. Shaikh Al Qattan contributed to drafting the Personal Status Law for the Ministry of Justice and is a regular participant in Islamic committees, courses, seminars and conferences.

#### Dr. Mohamed Abdulhakim Zoair - Member & Committee Secretary

Dr. Zoair holds Ph.D. in Islamic Economy; Masters degree in Islamic Shari'a (Economy); Bachelor's degree in Management Sciences; and a Higher Diploma in Islamic Studies. He is Member of the Fatwa Board in a number of Islamic financial institutions and has 18 years experience with Egypt Central Bank. Dr. Zoair was also the Head of Shari'a compliance in Dubai Islamic Bank.

## Executive Management Team



Sitting: Yousif Abdulla Taqi.  
Standing (R-L): Mohamed Paracha, Dr. Omar Marwan Kamal, Dr. Hassan Mahmood Al Bastaki, Mukundan Raghavachari, Nabeel Ebrahim Al Tattan, Marco Dondi.

### Yousif Abdulla Taqi - Chief Executive Officer

A Certified Public Accountant (CPA) and BSc in Accounting, Mr. Taqi has over 24 years' experience in the banking and financial services industry. During his career Mr. Taqi worked in leading positions for a number of institutions in the Kingdom of Bahrain. Prior to joining Al Salam Bank – Bahrain, he was Deputy General Manager of Kuwait Finance House (KFH) Bahrain, and was responsible for establishing Kuwait Finance House Malaysia. Before this, Mr. Taqi spent 20 years with Ernst & Young, during which time he provided professional services for many regional and international financial institutions. During his career with Ernst and Young, Mr. Taqi was promoted to Partner, responsible for providing auditing and consultancy services to the Islamic financial firms. He is currently Chairman of Al Salam Bank's recently established real estate development company.

### Ahmed Swaleh Abdisheikh - Executive Vice President, Chief Risk Officer & Compliance Group Head

Mr. Abdisheikh is a qualified Chartered Accountant (South Africa) and a member of South African Institute of Chartered Accountants (SAICA) and Global Association of Risk Professionals (GARP). Mr. Abdisheikh has over 11 years combined experience in audit profession, risk management and financial services. Mr. Abdisheikh spent 5 years with Deloitte & Touche Tohmatsu working in South Africa, New Zealand and Qatar. In the last 5 years he spent most of his time in the development and implementation of enterprise-wide risk management systems and processes including the implementation of Basel II in two prominent Qatari institutions. Prior to joining the Bank, he was Assistant General Manager- Market & Operational Risk at Qatar National Bank.

## Executive Management Team (continued)

### Dr. Hassan Mahmood Al Bastaki - Executive Vice President, Operations, IT and Support Services Group Head

Dr. Al Bastaki holds a Ph.D. in Accounting from the University of North Texas, USA. He has over 20 years' experience of working in the Kingdom of Bahrain and North America. He was Secretary General of the Bahrain Centre for Studies and Research. His private sector experience includes senior management and specialist positions with one of the international auditing firms. In the academic world, Dr. Al Bastaki was Vice President for Finance & Administration at the University of Bahrain. Dr. Al Bastaki is an Arbitrator and Expert at the Bahrain-based GCC Commercial Arbitration Centre and was appointed by a Royal Decree as a member in the Bahrain Tender Board for the period from 2003 to 2007.

### Mohamed Paracha - Executive Vice President, General Counsel

A qualified Solicitor (English Law), Mr. Paracha holds a Bachelor degree in Law (LLB Hons.) from Brunel University, UK and a Postgraduate Diploma in Law from the College of Law, UK. He was Partner Designate at the international law firm Norton Rose. Notable career achievements by Mr. Paracha include being named as 'Lawyer of the Year' in 2004 and in their Hot 100 list in 2007 by the prestigious legal publication, The Lawyer. He served as a member of the Bank of England Working Party on Islamic Finance, assisted in the formation of the Islamic Bank of Britain, and advised Lloyds TSB on the establishment of an Islamic banking window.

### Mukundan Raghavachari - Executive Vice President, Chief Financial Officer

A Chartered Accountant and a Certified Public Accountant (CPA) from Colorado state, USA, Mr. Raghavachari has over 20 years' experience in the financial services industry. During his career, he has worked in several countries in the Middle East, including Bahrain, Egypt, Kuwait, Lebanon, Qatar and the UAE. Prior to joining Al Salam Bank - Bahrain, he held the position of Group Head of Strategic Development at Ahli United Bank. Mr. Raghavachari is an Associate Member of the Institute of Chartered Accountants of India.

### Nabeel Ebrahim Al Tattan - Executive Vice President, Banking Group Head

A Chartered Financial Analyst (CFA), with 19 years experience in banking, investment and wealth management. Mr. Al Tattan spent seven years with Arcapita Bahrain, where his last position was Director, Investment Placement. Before this, he held senior management positions with Shuaa Capital UAE, SICO Bahrain, and Arab Insurance Group, Bahrain. He is experienced in setting up and managing investment portfolios for clients in areas such as treasury and fixed income, equities, derivative products, private equity and structured finance. Mr. Al Tattan has also assisted two regional stock exchanges in setting up their market index calculations.

### Dr. Omar Marwan Kamal - Executive Vice President, Investments Group Head

Dr. Kamal has extensive experience in the field of Islamic Financial Services, and his career to date has embraced financial consultancy, investment banking and academia. Through his diversified exposure, Dr. Kamal established a strong network in the Islamic Finance industry at an international level. He joined Al Salam Bank - Bahrain after working for Ernst & Young, where he became the Partner in Charge of the Islamic Financial Services Group (IFSG). He is recognized as a leading strategist within the industry and is considered a prominent figure in contemporary Islamic financial markets. A highly sought after speaker at industry conferences, Dr. Kamal is also a frequent contributor to international media.

### Marco Dondi - Senior Vice President, Head of Treasury and Capital Markets

Mr. Dondi has over 20 years' regional and international banking experience, specialising in treasury, money markets, derivatives trading, and bonds. He was Chief Dealer and Deputy Treasurer at BNP-Paribas Bahrain, where he held a global mandate for trading, marketing and sales on GCC and North African currencies. Before this, Mr. Dondi spent four years with Kuwait-based Gulf Bank and eight years with the Brussels branch of Sumitomo Bank.

In the name of Allah, the Most Compassionate, the Most Merciful



**Mohammed Alabbar**  
Chairman

#### Designated Board Members

Praise is to Allah who takes all things towards perfection;

On behalf of the Board of Directors, it is my privilege to present the first annual report of Al Salam Bank -Bahrain for the year ended 31 December 2006.

Al Salam Bank – Bahrain's first year has largely been a period of establishing corporate governance structure, recruiting competent senior management personnel and establishing the necessary policies and infrastructure as a prelude to launching a globally competitive Bank. Whilst a substantial portion of the time and effort of the Board and senior management has gone into establishing a robust infrastructure, attention has been paid to specifying the working activities and in selection of a state-of-the-art platform to facilitate the bank's operations to provide the best services for its share holders and to support the growth of the bank.

The Bank has adopted a unique universal one-stop-shop Islamic banking model and offers differentiated products and services targeting the middle and upper segment of the market. In the first phase which is planned for the first quarter of 2007, the bank will launch unique banking products targeting its corporate and individual clients in addition to marketing third party Takaful products to fulfill customers' appetite. Additionally, the Bank has achieved the endorsement of Visa International to issue Islamic cards and debit cards with an EMV embedded chip. Al Salam Bank-Bahrain will be the first institution to issue a card of this kind in the local market place.

In the second phase which is expected to start towards the end of 2007, the bank will be launching its own Takaful products in addition to the other services such as funds and asset management and private banking.

One of the core pillars of the bank strategy is to focus on Investment Banking capitalizing mostly on real estate investment for it is the most rewarding investment sector. The bank has secured a number of attractive real estate transactions in the GCC and South East Asia which offer attractive risk-return over the medium term. On the private equity side, we have a number of transactions in the pipeline from the Asia/Pacific region. The bank is focused on sourcing attractive private equity deals with emphasis on energy and healthcare sectors which will satisfy growing investor appetite for exposure to China, India and Pakistan.

As a start-up entity, Al Salam Bank-Bahrain faces the challenge of raising unrestricted investment deposits both from banks and customers, since correspondent banks and customers prefer dealing with institutions of track record or external rating. However, due to the credentials and experience of the senior management, the bank is confident of overcoming this challenge where the credibility is borne out by a good first year performance. This is evident from the fact that the bank managed to raise over BD20 million in deposits from inter-bank Murabaha and Mudaraba in the very first period of operations.

Financially, the first year of business has been impressive with a net profit of BD16.4 million (US\$ 43.5) achieved in less than a full year of operations. This represented a return on average equity of 15.1%. The gross operating income amounted to BD20.4 million (US\$ 54.1) and the operating expenses were BD4.0 million (US\$ 10.6 million). The cost-to-income ratio for the period was 19.6%. The earnings per share (EPS) for the period amounted to 151 fils.

The net income BD16,418,792 has been appropriated as follows:

	BD
Transfer to statutory reserve	1,641,879
Transfer to investment reserve	11,443,688
Charities & Donations	100,000
Retained earnings	3,233,225

Directors remuneration, fees and expenses for attendance at Board meeting for 2006 amounted to BD509,123.

The following table shows the percentage of share ownership in comparison to the number of shareholders as at 31st December 2006. It indicates that 12 shareholders owned 24% of the total shares, while 30 shareholders owned 19%. However, 57% of the shares are owned by over 22,000 investors.

Percentage of shares held	No. of shares	No. of Shareholders as at 31 December 2006	% of total outstanding shares
Less than 0.5%	68,320,159	22,542	57%
Between 0.5% and 1%	22,912,638	30	19%
Between 1% and 5%	28,750,000	12	24%
<b>Total</b>	<b>119,982,797</b>	<b>22,584</b>	<b>100%</b>

As required by the Central Bank of Bahrain rulebook, set out below are the interests of Directors and Senior Managers in the shares of Al Salam Bank - Bahrain B.S.C. and their distribution of the shareholding as of 31 December 2006.

Shares owners	No. of Shares held at 31 December 2006
Director's shares	2,400,000
Senior Manager's shares	505,787
<b>Total</b>	<b>2,905,787</b>

Finally, I would like, on behalf of myself and the Board members, to thank His Majesty King Hamad Bin Isa Bin Salman Al Khalifa, the King of Bahrain, His Highness Shaikh Khalifa Bin Salman Al Khalifa, The Prime Minister and His Highness Shaikh Salman Bin Hamad Al Khalifa, The Crown Prince and Commander-in-Chief of the Bahrain Defense Force for their continuous support. Also to express appreciation to the Central Bank of Bahrain, correspondents, customers, shareholders and employees of the Bank for their support and collective contribution for the first period of successful operations and we look forward to their continued support in the fiscal year 2007.

We Thank Allah the Most Compassionate, the Most Merciful.



**Husein Almeeza**  
Vice Chairman & Managing Director

The remarkable performance by Al Salam Bank - Bahrain during our first nine months of operations clearly illustrates the vision and foresight of our founding shareholders, who earlier identified the opportunity that exists for a truly universal bank, operating internationally and with a broad product range encompassing deposit taking, financing and investments.

Accordingly, we set ourselves the vision to be a leading force in the global Islamic financial services industry, by developing a strong presence in selected regions, providing a broad-based, differentiated Shari'a-compliant offering to focused segments, and by building a reputation as 'the trusted Islamic bank' while enhancing shareholder value.

This vision was strongly endorsed by the overwhelming support for the initial public offering of the Bank in April 2006. Oversubscribed 63 times and raising BD 2.7 billion in subscriptions, the IPO was the largest in the history of the Kingdom of Bahrain. Since the IPO and our subsequent listing on the Bahrain Stock Exchange, the progress of the Bank as a new player in the Islamic sector has been closely watched by the region's financial community.

I am therefore delighted to report that our progress to date has exceeded all expectations, and has helped to position the Bank as a dynamic, diversified and differentiated Islamic financial institution, more than capable of delivering upon its promise to all stakeholders. In a very short space of time, we have built a strong organisational infrastructure, achieved early business success, and grown our presence outside Bahrain to include Sudan and Algeria.

A key achievement of 2006 was our successful acquisition of a significant minority stake in El Nilein Banking Group, subject to regulatory approval. We competed with over 20 financial institutions that were bidding for the partial privatization of the Group, which has 34 domestic branches in Sudan and an international branch in Abu Dhabi, UAE. The acquisition of a strategic stake in El Nilein will contribute to the planned expansion of Al Salam Bank - Bahrain, and will provide the opportunity to penetrate the growing Sudanese market and gain a foothold in the important Emirates market.

Overall, this is an excellent start for a new bank with global aspirations. We now have everything in place to support our continued growth and development, and we are very optimistic about our future prospects. We are ready to launch full banking operations during the first quarter of 2007, and have built up a strong pipeline of investment deals. We also plan to introduce new treasury, asset management and trust services to meet the needs of our prestigious client base.

The year ahead will not be without its challenges, but with the grace of God, and the skills and determination of our management team and staff, we are confident in our ability to achieve our ambitious goals.

Committed to action, we firmly believe that results are measured by actions rather than words, as our progress to date has clearly illustrated.



**Yousif Abdulla Taqi**  
Chief Executive Officer

Following the initial legal, commercial and regulatory procedures, together with the launch of the IPO and subsequent listing on the Bahrain Stock Exchange, the key challenge was to build the institutional capacity of the Bank, especially in terms of processes, people, technology, and premises. At the same time, there was a need to begin sourcing new businesses in order to meet the expectations of the shareholders. For that reason, we established the different groups, departments and sections in order to satisfy the different roles and needs of business and support operations. The following is the review of the operations and activities in addition to the achievements of 2006.

### Banking Group

Al Salam Bank – Bahrain provides a comprehensive range of differentiated Shari'a-compliant products and solutions that cover retail banking, wealth management and corporate banking, supported by the highest levels of personalized professional service.

**Retail Banking** activities are targeted at the middle-to-upper segment of the market. During the year 2006, excellent progress was made towards the planned launch of full-fledged retail banking operations during the first quarter of 2007. The fitting-out of a prestigious banking hall at the Bank's headquarters in the Seef district was completed; arrangements were finalized for the issue of the first Islamic chip-based ATM card with an EMV-embedded chip; while connectivity to the Visa, Benefit and GGCNet ATM networks is currently in progress it is expected to be accomplished by the end of the first quarter of 2007.

The Bank's retail liability products include current, savings and call accounts; Murabaha, Wakala, and Mudaraba deposits. Asset products include Murabaha, Ijarah, Istisna'a and Musharaka, with different financing purposes such as vehicles, property and investments. In addition, the Bank is planning to offer a range of Takaful (Islamic insurance) products. These will be provided initially through carefully selected third parties, and eventually offered directly by the Bank. The provision of additional delivery channels, including e-Banking and a Call Centre service, is planned for mid-2007.

**Wealth Management** services are provided for ultra high net worth and high net worth individuals in the GCC and MENA region. The main focus during the year was on finalizing the product suite in line with the needs of the Bank's clients. These include investment funds and private equity investments, Sukuks, commodities and precious metals trading, plus brokerage, leverage and safe custody services. In addition, the Wealth Management team will monitor clients' portfolios and recommend changes as and when needed. During 2006, the Bank initiated discussions to establish strategic alliances with international product providers in order to be able to serve clients' needs on a global basis.

**Corporate Banking** services are focused on meeting the specific financial needs of large corporations, medium sized commercial organizations, and small-to-medium enterprises (SMEs), which are looking for professional consultancy services and innovative solutions to support the growth and expansion of their business activities. Banking activities are offered beyond the boundaries of Bahrain to the GCC and other selective regional markets. During 2006, the Bank was successful in establishing a sizable initial corporate client base, building a strong asset portfolio, and attracting significant deposits. At the same time, the Corporate Banking team developed a macro-level strategy for the next three years, and implemented internal processes and procedures to ensure the highest levels of operational efficiency and effectiveness, and client service.

#### Investments Group

The Bank has developed a diversified investment strategy, differentiated by geographic and sector focus, to meet the expectations and demands of its clients and ensure high returns to its shareholders, while adding value to the community and positively impacting the environment. The Investments Group comprises two specialist units that cover corporate investments and real estate investments. Corporate investments are primarily focused on the Asia and Asia-Pacific region, with particular emphasis on the energy and alternative energy sectors. Real estate investments focus on the Asia-Pacific, GCC and Middle East regions, with a primary concentration on real estate development projects rather than just investment in income-generating properties. During 2006, the Bank made good progress in implementing its investment strategy.

In partnership with strategic investors, the Bank established a real estate development company to focus specifically on projects in the Kingdom of Bahrain with the potential to make a lasting contribution to the social and economic well-being of the community. The new company, which will be officially launched in early 2007, has already concluded a major real estate transaction.

In its first real estate investment outside Bahrain, the Bank partnered with Malaysian-based CIMB Islamic Bank and E&O Property Development Berhad, and Mapletree Investments of Singapore, to develop a seafront villa component of the Seri Tanjung Penang development on Penang Island. To be launched during the first half of 2007, the project will involve building 73 sea-fronting luxury villas on a landscaped plot of 980 acres. The properties will be targeted at foreigners and Malaysian nationals seeking upper class homes in Penang. The initial outlay of the project is estimated at around US\$ 20 million. Seri Tanjung Pinang is reputed to be the largest land reclamation waterfront project undertaken to date in Malaysia.

Supporting its Asia-Pacific regional focus, in late 2006 the Bank finalized negotiations for a strategic partnership agreement with CMIA Capital Partners (CMIA), which was subsequently signed in early 2007. Headquartered in Singapore, with offices in Shanghai and Hong Kong, CMIA is a leading regional private equity firm with particular experience in China. The partnership between Al Salam Bank – Bahrain and CMIA will involve an initial investment of up to US\$ 100 million in successful medium-sized companies seeking growth capital, across a diversified range of sectors. As one of the leading emerging markets in the world, with GDP growth forecast to average over nine per cent over the next few years, China offers significant attractive investment opportunities.

Having built a strong pipeline of deals, the prospect for the Bank's investment activities in 2007 is extremely positive. The Bank has identified a number of new attractive real estate opportunities in Bahrain, the GCC and South East Asia, as well as promising private equity opportunities in emerging markets such as China, the Asian Subcontinent, and other Asia-Pacific countries.

#### Treasury & Capital Markets

One of the key strategic objectives of Al Salam Bank - Bahrain is to be recognised as a leading provider of Islamic treasury and asset management products and services, and to develop a strong reputation with Islamic and conventional financial institutions. During 2006, the Bank established a number of specialist teams responsible for managing proprietary treasury and related activities, and also for providing treasury and asset management services to institutional, corporate and private clients. Core activities include financial institutions relationships, asset and liability management, foreign exchange and commodities, product structuring activities, and investment in equities and securities.

As a start-up entity, with no established track record or external ratings history, the Bank faces the challenge of being able to attract unrestricted investment deposits. However, with the calibre and credentials of the Bank's Senior Management, and its success in establishing relationships with other financial institutions, Al Salam Bank – Bahrain was able to raise a considerable amount of deposits from interbank Murabaha and Mudaraba during the first period of operations.

#### Trust Services

During 2006, Al Salam Bank - Bahrain focused on developing a range of innovative Shari'a-compliant trust services – the first to be offered by an Islamic bank – for corporations, family businesses, high net worth families and individuals, which are planned to be formally launched in 2007.

The Bank initially plans to provide offshore trust services to meet tax, inheritance, wealth consolidation, and other specific needs of its clients. There is a large untapped potential for Islamic trust business in the region, and the Bank has already been approached by high net worth individuals wishing to avail themselves of such services

#### Finance & Credit Group

The Finance Group comprises the functions of Financial Controls, Management Information Systems (MIS), Credit, and Investment Administration.

During 2006, the Group established a robust strategic business plan and the reporting requirements necessary to meet the medium term needs of regulators as well as the Board and Senior Management of the Bank. The Group also successfully implemented the accounting and reporting modules of the core banking system. Currently, the Group is in the process of selecting and implementing a data warehousing solution for budgeting, regulatory reporting and management accounting to produce timely and accurate reports to support the business requirements. This process will be completed during 2007 and will provide relevant and reliable information to enable effective decision making.

On the Credit front, the Group is actively involved in working with the Risk Group in the policy formulation as far as credit risk is concerned. In addition, the Group is responsible for credit analysis and recommendation, credit administration, and ongoing monitoring of all the credit facilities. During 2006, the Group developed risk rating criteria for financing facilities to financial institutions, corporates and retail clients. The Group has also made good progress in developing an Internal Risk Grading System to provide a systematic methodology for analyzing credit risk across the Bank in a consistent manner.

#### Operations, IT and Support Services Group

During 2006, Al Salam Bank - Bahrain established a number of specialised support functions, including human resources, information technology, administration, banking operations and corporate communications, to support the Bank's business divisions.

In the area of **Human Resources**, the Bank was successful in identifying and attracting some of the best people in the industry. The Bank now has in place a high-calibre management team, and has filled all key banking and support positions. This was a considerable achievement, given the limited availability of experienced and qualified Islamic banking professionals due to the rapid growth of the industry and the entry of many new players to the market.

The challenge now is to minimize staff attrition in a highly competitive market, while continuing to attract additional resources to support the Bank's growth and expansion. Accordingly, the Bank has retained the services of a leading international HR consultancy to develop a first class management performance and measurement system, and introduce a staff incentive program.

**Information Technology** has become a critical business driver and value-added enabler for financial institutions. In 2006, the Bank signed an agreement with the Swiss IT system provider Temenos for the provision of a state-of-the-art core banking system. Phase one of the implementation plan was completed before the year-end, with the successful testing and commissioning of a general ledger application. Subsequent phases, including critical front office client-facing applications, are due to be implemented to support the launch of full-fledged banking operations during the first quarter of 2007.

A key **Administration** achievement during 2006 was the identification of a suitable new headquarters building and the smooth relocation from the Bank's initial temporary accommodation, which was achieved by the targeted date of November 2006. The new premises provides a smart working environment for staff and comfortable and convenient facilities for clients. The Bank now has in place efficient support services, including safety and security, maintenance, and mail and cargo, as well as a fully automated purchasing system.

**Banking Operations** is a key back office function, responsible for ensuring the accurate, smooth, speedy and high quality processing of all banking transactions. During 2006, the Bank established nostro correspondent relations with a number of local, regional and global financial institutions, and achieved SWIFT membership and connectivity.

The Bank is committed to adopting the highest international standards of **Corporate Communications**. During 2006, policies and procedures were developed and introduced to ensure that all communications with the Bank's stakeholders – both internal and external – are conducted in a professional, transparent, accurate and timely manner, and that the Bank's image and brand equity is adequately protected. A pro-active relationship with the media was established, an informative and user-friendly website was launched, and a range of high quality corporate and marketing collateral and exhibition support materials were produced.

At Al Salam Bank - Bahrain we appreciate the fact that we are in the business of taking risks and our success is largely dependent on how efficiently we identify, measure, control and manage these risks. Hence, we view risk management as a core competency and from a strategic point of view, we view the Basel II Accord as a catalyst to the successful implementation of risk management in the Bank.

The fundamental principle underlying our risk management framework is ensuring that accepted risks are within Board approved risk appetite and the returns are commensurate with the risks taken. The objective is creating shareholder value through protecting the Bank against unforeseen losses, ensuring maximization of earnings potential and opportunities vis-à-vis the Bank's risk appetite and ensuring earning stability.

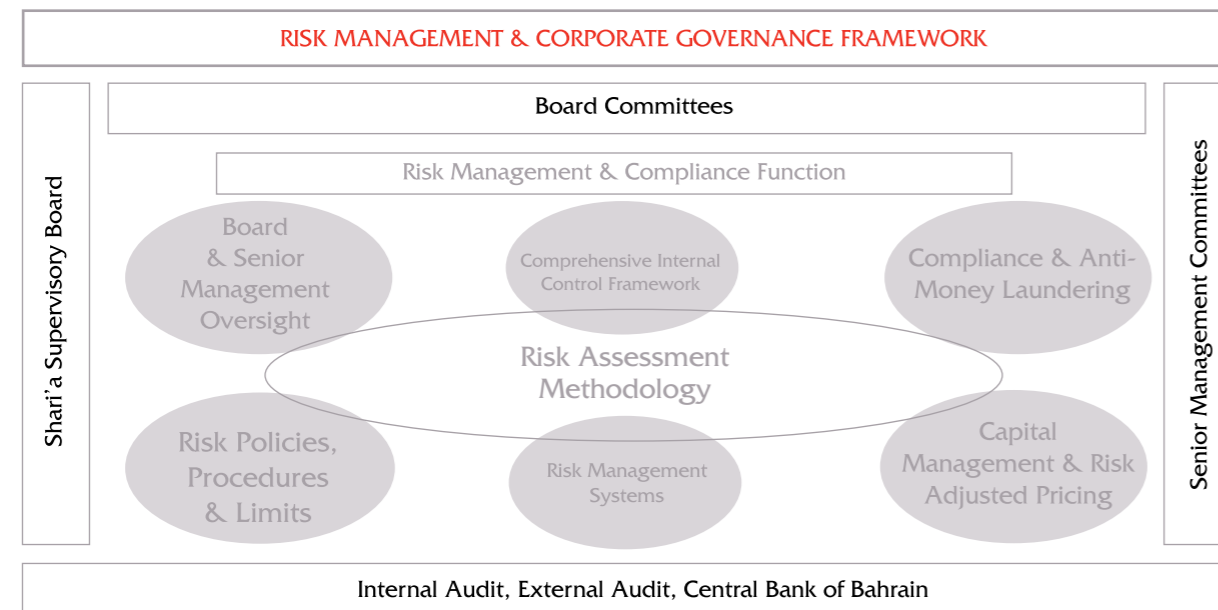
With this in mind, the Bank's establishment plan gave priority to the development of an effective and practical risk management framework and independent risk management and compliance function in line with best risk management practice locally and internationally, the requirements of Central Bank of Bahrain and the Basel II Accord.

#### Risk Management Framework

The risk management framework defines the risk culture of Al Salam Bank - Bahrain and sets the tone throughout the Bank to practice the right risk behavior consistently to ensure that there is always a balance between business profits and risk appetite.

The risk management framework achieves this through the definition of the Bank's key risk management principles covering credit, market, operational, strategic and reputation risks, the role and responsibilities of the Board, Risk Management group and Senior Management towards risk management, the risk assessment methodology based on likelihood and consequences, the major risk policies, procedures and risk limits, the risk management information systems and reports, the internal control framework and the Bank's approach to capital management. The effectiveness of the risk management framework is independently assessed and reviewed through Internal audits, External audits and Central Bank of Bahrain supervision.

As a result, the risk management framework creates an alignment between business and risk management objectives.



### Capital Management

In the cornerstone of all of this, is the optimization of a risk-reward relationship against the capital available through a focused and well monitored capital management process involving Risk Management, Finance and Business groups.

### Corporate Governance

The risk management framework is supported by an efficient Corporate Governance Framework discussed on pages 28 to 30.

### Risks Ownership

The implementation of the risk management framework bank-wide is the responsibility of the Risk Management & Compliance Group. Ownership of the various risks across the Bank lies with the business and support Heads and it is their responsibility to ensure that these risks are managed in accordance with the risk management framework. Risk Management will assist business and support heads in identifying concerns and risks, identifying risk owners, evaluating risks as to likelihood and consequences, assessing options for accommodating the risks, prioritizing risk management efforts, developing risk management plans, authorizing implementation of risk management plans and tracking risk management efforts.

### Risk Management and Compliance Organisation

Al Salam Bank- Bahrain risk management function is headed by an independent Chief Risk Officer & Compliance Head with direct reporting line to the Chief Executive Officer.



### Compliance & Anti-Money Laundering Unit

The Bank has established an independent and focused unit to coordinate the implementation of compliance and Anti-Money Laundering and Anti-Terrorist Financing program. The program covers policies and procedures for managing compliance with regulations, anti-money laundering, disclosure standards on material and sensitive information and insider trading.

In line with its commitment to combat money laundering and terrorist financing, Al Salam Bank - Bahrain through its Anti-Money Laundering policies ensures that adequate preventive and detective internal controls and systems operate effectively. The policies govern the guidelines and procedures for client acceptance, maintenance and monitoring in line with Central Bank of Bahrain and International standards such as FATF 40 + 9 recommendations.

The compliance program also ensures that all applicable Central Bank of Bahrain regulations are complied with and/or non-compliance is detected and addressed in a timely manner. The program includes compliance with regulations set by Bahrain Stock Exchange and Ministry of Industry & Commerce.

**2007 Plan**

The focus of the Risk Management and Compliance Group in 2007 will be on the implementation of the Risk Management framework, related risk policies and procedures, the Basel II Accord in line with the Central Bank of Bahrain time-table and selected risk management systems. With this in mind, Al Salam Bank - Bahrain will seek to leverage Basel II as a catalyst to implementing best risk management practices and fostering a common language for communicating risks to the Board, management and staff, shareholders and clients.

The Board is committed to establishing the highest standards in corporate governance. To this end, it has established various committees in line with industry best practice and has also directed the Senior Management to establish various management committees with relevant members. The Board Charter imposes the highest level of ethical conduct; doing what it proclaims to be its responsibility; reporting results with accuracy and transparency in a timely manner; and ensuring full compliance with the by-laws, and the rules and regulations that govern the Bank's business. The Board has adopted a Board Charter, which together with the Bank's Memorandum and Articles of Association and the Charters of various Board Committees, provides the authority and practices for governance of the Bank.

The Board provides central leadership to the Bank. It has established and defined the objectives and strategies that direct the ongoing activities of the Bank to enable it to achieve its objectives. The roles and responsibilities of the Board of Directors, their independence, code of conduct and ethics are described in the Board Charter.

The Bank is organized as follows:



**Board Committees**

Consistent with the industry’s best practice, the Board has established three Committees with defined roles and responsibilities. The Standing Committees of the Board are the Executive Committee, the Audit Committee, and the Remuneration Committee.

**Executive Committee**

Has delegated authority within the overall Board authority. Provides direction to the executive management on all business matters and assumes the role of the Board to address matters arising between Board meetings. The Committee is responsible for business matters concerning credit and market risks, strategy review and recommendation to the Board.

**Audit Committee**

Has responsibility to assist the Board in discharging its oversight duties relating to matters such as risk and compliance, including the integrity of the Bank’s financial statements, financial reporting process and systems, internal controls and financial controls. The Committee also, acts as a liaison between the External auditors and the Board and between the Regulators and the Board.

**Remuneration Committee**

The role is to provide a formal and transparent procedure for developing a compensation policy for the Managing Director, the Chief Executive Officer and senior management; ensures that compensation offered is competitive, in line with the market/peer group and consistent with the responsibilities assigned to employees. The Committee approves policies covering hiring, compensation and training. In addition, the Committee recommends to the Board special compensation plans, including annual performance bonus and short/long term incentives, to attract, motivate and retain key employees.

**Management Committees**

The Chief Executive Officer is supported by a number of management committees each having a specific mandate to give focus to areas of business, risk and strategy. The various committees and their roles and responsibilities are:

Committee	Roles and responsibilities
Credit/Risk Committee	Recommending the risk policy and framework to the Board. Primary role is the selection and implementation of risk management systems, portfolio monitoring, stress testing, risk reporting to Board, Board Committees, Regulators and Executive Management. In addition to these responsibilities, individual credit transaction approval and monitoring is an integral part of the responsibilities.
Asset Liability Committee	This Committee’s primary responsibility is to review the trading and liquidity policy for the overall management of the balance sheet and its associated risks.
Investment Committee	The role of the Committee is to review and approve all transactions related to corporate and real estate investments and monitoring their performance on an ongoing basis. In addition, the Committee is responsible to oversee the performance of the fund managers and recommend exit strategies to maximize return to its investors.
Technology Steering Committee	TSC oversees the information technology function of the Bank. It recommends the annual IT budget and plans, drawn up in accordance with the approved strategy for the Bank, to the CEO for submission to the Board of Directors for their approval. It supervises the implementation of the approved IT annual plan within set deadlines and budgetary allocations.

### Code of Conduct

The Bank conducts itself in accordance with the highest standards of ethical behaviour. A Code of Business Conduct has been developed to govern the personal and professional conduct of all stakeholders.

### Compliance

The Bank has in place comprehensive policies and procedures to ensure full compliance with the relevant rules and regulations of the Central Bank of Bahrain and the Bahrain Stock Exchange, including money laundering, prudential and insider trading reporting.

### Communications

The Bank conducts all communications with its stakeholders in a professional, honest, transparent, understandable, accurate and timely manner. Main communications channels include annual reports, corporate brochure and website, and regular announcements in the appropriate local media and the internet.

As inspired from its name Al Salam Bank – Bahrain strives to spread peace, serenity and happiness to the members of the community by its conduct and support of various social minded programmes in Bahrain.

As an Islamic financial institution, Al Salam Bank – Bahrain takes its responsibility very sincerely to contribute to the social and economic well-being of the communities in which it operates.

Al Salam Bank – Bahrain's corporate social responsibility initiatives cover three main areas: career opportunities for Bahrain; contribution in the growth of the Islamic banking industry; and contributing to charity and donations to worthwhile causes.

### Career Opportunities for Bahrainis

In line with its commitment to providing young Bahraini nationals with rewarding career opportunities, Bahrainis accounted for 77 per cent of all employees at the end of 2006. Al Salam Bank – Bahrain is rewarding the Bahraini nationals for their invaluable contribution to the Banks' success with the following:

- Competitive remuneration package.
- Free medical takaful for staff and their families.
- Life and personal accident takaful.
- Free retail-banking basic service for staff and their families.
- Tailored in-house, local and overseas training courses.
- Social activities led by the executive management and Board members.

### Participating in the growth of the Islamic Banking industry

The Bank is equally committed to contributing to the growth and development of the Islamic banking and finance industry. In 2006, the Bank sponsored and supported the following:

- The publication of the third World Islamic Banking Conference McKinsey Competitiveness Report.
- The initiatives of the Bahrain Institute of Banking and Finance and Accounting.
- The Bahrain-based Auditing & Accounting Organization for Islamic Financial Institutions.
- The Islamic Financial Services Board in Malaysia.

### Contributing to charity and donations

Also during 2006, the Bank made financial donations to a number of charitable, social, cultural, scientific, medical and educational organizations, and other worthwhile causes. The bank has set aside part of its 2006 profit for charitable activities, social welfare and other donations in 2007.

In the name of Allah, The Beneficent, The Merciful  
Praise be to Allah, the Lord of the worlds, and blessing and peace be upon His Prophet Mohammad and the people of His house and His companions.

Firstly:

The Shari'a Supervisory Board ('The Board') of Al-Salam Bank Bahrain B.S.C. supervised the Bank's activities and transactions which were carried out during the year. They guided the various departments of the Bank to comply with the principles of Islamic Shari'a and with specific Fatwa rulings and guidelines issued by the Board with regards to those activities and transactions. The Board has conducted various meetings with the Bank's Management and acknowledged that they have been complying with the principles of Islamic Shari'a and the Shari'a Supervisory Board Fatwas.

Secondly:

The Board has reviewed the contract and agreement templates and asked the Bank's management to implement those templates. Moreover, the Board decided to prepare a plan for the employees to be trained in the new Shari'a agreements and this should be implemented immediately.

Thirdly:

The Board has reviewed the financial statements and the related notes and disclosures. The Board believes that:

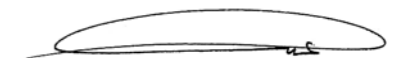
1. These financial statements fairly represent the Bank's assets and revenues.
2. The Bank received various deposits as Wakala investments or Reverse Murabaha where profits were paid to account holders. The Board recommended preparing a comprehensive system to receive deposits and distribute the profits between the shareholders and the account holders. These deposits should be commingled with the shareholder funds in one pool and invested in Shari'a compliant investments such as Murabaha, Istisna'a or Ijarah contracts etc.

We pray that Allah may Grant all of us Further Success and Prosperity

Shari'a Supervisory Board Members:



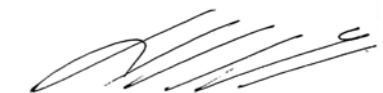
**Dr. Shaikh A. Hussein Hamed Hassan**  
Chairman of Shari'a Supervisory Board



**Shaikh Adnan Abdullah Al Qattan**  
Member of Shari'a Supervisory Board



**Dr. Shaikh Ali Mohiuddin**  
Member of Shari'a Supervisory Board



**Dr. Shaikh Ali Mohammed Abdulhakeem**  
Member of Shari'a Supervisory Board

## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDER'S OF AL SALAM BANK- BAHRAIN B.S.C.

We have audited the accompanying financial statements of Al-Salam Bank Bahrain B.S.C. ("the Bank"), which comprise the balance sheet as at 31 December 2006 and the income statement, statement of changes in equity and cash flow statement for the period 19 January 2006 to 31 December 2006, and a summary of significant accounting policies and other explanatory notes.

**Board of Director's Responsibility for the Financial Statements**

The Board of Directors are responsible for the preparation and fair presentation of these financial statements in accordance with both Financial Accounting Standards issued by Accounting and Auditing Organization for Islamic Financial Institutions, to operate in accordance with Islamic Shari'a and International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of 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. In addition, the Board of Directors are responsible for the banks undertaking to operate in accordance with Islamic Shari'a Rules and Principles.

**Auditors' Responsibility**

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

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

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

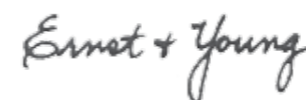
**Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2006 and of its financial performance and its cash flows for the period 19 January 2006 to 31 December 2006 in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions and the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

In addition, in our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2006 and of its financial performance and its cash flows for the period 19 January 2006 and 31 December 2006 in accordance with International Financial Reporting Standards.

**Other Regulatory Matters**

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the financial statements, and the contents of the Report of the Board of Directors relating to these financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank have occurred during the period 19 January 2006 to 31 December 2006 that might have had a material adverse effect on the business of the Bank or on its financial position, and that the Bank has complied with the terms of its banking licence. We obtained all the information and explanations which we required for the purpose of our audit.



28 January 2007  
Manama, Kingdom of Bahrain

## Balance Sheet

31 December 2006

	Notes	31 December 2006 BD
<b>ASSETS</b>		
Cash and balances with Central Bank of Bahrain	3	2,942,042
Murabaha and Mudaraba with banks	4	105,089,786
Murabaha financing		22,963,267
Ijarah Muntahia Bittamleek		10,382,429
Non-trading investments	5	32,618,646
Investment properties		1,177,528
Receivables and prepayments	6	10,857,954
Premises and equipment		2,026,884
<b>TOTAL ASSETS</b>		<b>188,058,536</b>
<b>LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY</b>		
<b>LIABILITIES</b>		
Murabaha from banks		23,647,305
Customers' current accounts		5,673,812
Other liabilities		2,223,863
		<u>31,544,980</u>
<b>UNRESTRICTED INVESTMENT ACCOUNTS</b>	7	<u>20,111,967</u>
<b>EQUITY</b>		
Share capital	8	120,000,000
Treasury stock	8	(17,203)
Reserves and retained earnings	9	16,418,792
		<u>136,401,589</u>
<b>TOTAL LIABILITIES, UNRESTRICTED INVESTMENTS ACCOUNTS AND EQUITY</b>		<b>188,058,536</b>

The financial statements have been authorised for issue in accordance with a resolution of the Board of Directors on 28 January 2007.

		
Mohammed Al-Abbar Chairman	Hussein Mohammed Almeeza Vice Chairman & Managing Director	Yousif Taqi Chief Executive Officer

The notes on pages 38 to 55 form part of these financial statements.

## Statement of Income

19 January 2006 to 31 December 2006

	Period from 19 January 2006 to 31 December 2006 BD
<b>OPERATING INCOME</b>	
Income from Murabaha and Mudaraba	8,501,816
Income from other Islamic financing contracts	643,221
	<u>9,145,037</u>
Profit paid on Murabaha from banks	(42,368)
Share of profit to unrestricted investment account holders	(387,697)
	<u>8,714,972</u>
Gain on investments designated at fair value through profit or loss	11,443,688
Fees and commission	254,381
Foreign exchange gains	15,792
<b>TOTAL OPERATING INCOME</b>	<b>20,428,833</b>
<b>OPERATING EXPENSES</b>	
Staff costs	2,393,760
Premises and equipment cost	219,525
Depreciation	54,633
Other operating expenses	1,342,123
<b>TOTAL OPERATING EXPENSES</b>	<b>4,010,041</b>
<b>NET PROFIT FOR THE PERIOD</b>	<b>16,418,792</b>
<b>WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING</b>	<b>108,977,778</b>
<b>BASIC AND DILUTED EARNINGS PER SHARE (FILS)</b>	<b>151</b>

The notes on pages 38 to 55 form part of these financial statements.

## Statement of Cash Flows

19 January 2006 to 31 December 2006

	Period from 19 January 2006 to 31 December 2006
	BD
<b>OPERATING ACTIVITIES</b>	
Net profit for the period	16,418,792
Adjustments:	
Depreciation	54,633
Changes in fair value of investments carried at fair value through profit or loss	(11,443,688)
Operating income before changes in operating assets and liabilities	5,029,737
Mandatory reserve with Central Bank of Bahrain	(930,000)
Murabaha and Mudaraba with Banks with original maturities of 90 days or more	(14,816,100)
Murabaha financing	(22,963,267)
Ijarah Muntahia Bittamleek	(10,382,429)
Receivables and prepayments	(10,857,954)
Customers' current accounts	5,673,812
Murabaha from banks	23,647,305
Other liabilities	1,935,676
<b>Net cash used in operating activities</b>	<b>(23,663,220)</b>
<b>INVESTING ACTIVITIES</b>	
Premises and equipment	(2,081,517)
Investment properties	(1,177,528)
Non-trading investments	(20,886,771)
<b>Net cash used in investing activities</b>	<b>(24,145,816)</b>
<b>FINANCING ACTIVITIES</b>	
Issue of equity shares, net of treasury stock	119,982,797
Unrestricted investment accounts	20,111,967
<b>Net cash from financing activities</b>	<b>140,094,764</b>
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>	<b>92,285,728</b>
<b>Cash and cash equivalents comprise of:</b>	
Cash and other balances with Central Bank of Bahrain	505,920
Balances with other banks	1,506,122
Murabaha and Mudaraba with banks with original maturities of less than 90 days	90,273,686
	92,285,728

The notes on pages 38 to 55 form part of these financial statements.

## Statement of Changes In Equity

19 January 2006 to 31 December 2006

	Share Capital	Treasury Stock	Statutory Reserve	Retained Earnings	Investment Reserve	Total Equity
	BD	BD	BD	BD	BD	BD
Proceeds from issue of share capital (Note 8)	120,000,000	(17,203)	-	-	-	119,982,797
Net profit for the period	-	-	-	16,418,792	-	16,418,792
Transfer to statutory reserve (Note 9)	-	-	1,641,879	(1,641,879)	-	-
Transfers	-	-	-	(11,443,688)	11,443,688	-
<b>Balance at 31 December 2006</b>	<b>120,000,000</b>	<b>(17,203)</b>	<b>1,641,879</b>	<b>3,333,225</b>	<b>11,443,688</b>	<b>136,401,589</b>

The notes on pages 38 to 55 form part of these financial statements.

**1 INCORPORATION AND PRINCIPAL ACTIVITIES****a) Incorporation**

Al-Salam Bank-Bahrain B.S.C. ("the Bank") was incorporated in the Kingdom of Bahrain under the Bahrain Commercial Companies Law No. 21/2001 and was registered with the Ministry of Industry and Commerce under Commercial Registration Number 59308 on 19 January 2006. The Bank is regulated and supervised by the Central Bank of Bahrain (CBB) (formerly the Bahrain Monetary Agency) and has a retail Islamic banking licence and is operating under Islamic principles, and in accordance with all the relevant regulatory guidelines for Islamic banks issued by the CBB. The Bank's registered office is P.O. Box 18282, Building 22, Avenue 58, Block 436, Al Seef District, Kingdom of Bahrain.

**b) Principal activities**

The Constituent Statutory General Assembly Meeting held on 17 April 2006 declared commencement of commercial operations with effect from the date of that meeting. The Bank offers a full range of Islamic banking services and products. The activities of the Bank include accepting Shari'a money placements/deposits, managing Shari'a profit sharing investment accounts, offering Shari'a financing contracts, dealing in Shari'a compliant financial instruments as principal/agent, managing Shari'a compliant financial instruments and other activities permitted for under the CBB's Regulated Banking Services as defined in the licensing framework.

**2 ACCOUNTING POLICIES****2.1 BASIS OF PREPARATION**

The financial statements are prepared on a historical cost basis, except for investments held at fair value through profit or loss, investment properties and available-for-sale investments, that have been measured at fair value.

**Statement of compliance**

The financial statements of the Bank are prepared in accordance with the Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and International Financial Reporting Standards (IFRS) and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law.

These financial statements are presented in Bahraini dinars, being the functional currency of the Bank.

**2.2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES**

The preparation of the financial statements requires management to make judgements and estimates that affect the reported amount of financial assets and liabilities and disclosure of contingent liabilities. These judgements and estimates also affect the revenues and expenses and the resultant provisions as well as fair value changes reported in equity.

Judgements are made in the classification of available-for-sale, fair value through profit or loss or held-to-maturity investments based on management's intention at acquisition of the financial asset. As fully described below, judgements are also made in determination of the objective evidence that a financial asset is impaired.

**2.2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)***Classification of investments*

Management decides upon acquisition of an investment whether it should be classified as fair value through profit or loss, available for sale or held-to-maturity.

*Impairment of available-for-sale equity investments*

The Bank treats available-for-sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. In addition, the Bank evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

**Estimation uncertainty**

The key assumptions concerning the future and other key sources of estimating 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 financial contracts*

The Bank reviews its problem financial contracts on a regular 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.

*Collective impairment provisions on financial contracts*

In addition to specific provisions against individually significant financial contracts the Bank also considers the need for a collective impairment provision against financial contracts which although not specifically identified as requiring a specific provision have a greater risk of default than when originally granted. This collective provision is based on any deterioration in the status, as determined by the Bank, of the financial contract since it was granted (acquired). The amount of the provision is based on the historical loss pattern for other contracts within each grade and is adjusted to reflect current economic changes.

*Valuation of unquoted equity investments*

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

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

The Bank calibrates the valuation techniques periodically and tests these for validity using either prices from observable current market transactions in the same instrument or other available observable market data.

### 2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below:

#### Financial contracts

Financial contracts consist of cash and balances with banks and the Central Bank of Bahrain, Murabaha receivables (net of deferred profit), Mudaraba and Ijarah Muntahia Bittamleek. Balances relating to these contracts are stated net of provisions for impairment.

#### Murabaha receivables

Murabaha receivables are stated net of provision for impairment and deferred profits.

#### Ijarah Muntahia Bittamleek

Ijarah Muntahia Bittamleek assets comprises assets under lease, mainly aircraft, land and buildings, under terms that would transfer ownership of the assets to third parties at the end of the respective lease period.

#### Non-trading investments

These are classified as held-to-maturity, available-for-sale or fair value through profit or loss.

All investments are initially recognised at cost, being the fair value of the consideration given including acquisition costs associated with the investment.

Following the initial recognition of investments, the subsequent period-end reporting values are determined as follows:

#### *Investments held-to-maturity*

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

#### *Investments available-for-sale*

After initial recognition, investments which are classified “available-for-sale” are normally remeasured at fair value, unless the fair value cannot be reliably determined, in which case they are measured at cost less impairment. Fair value changes 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 value” within equity, is included in the statement of income for the period.

#### *Investments carried at fair value through profit or loss*

Investments in this category are designated as such on initial recognition if these investments are evaluated on a fair value basis in accordance with the risk management policy and its investment strategy. These include all private equity investments including those in joint ventures and associates.

Investments at fair value through profit or loss are recorded in the balance sheet at fair value. Changes in fair value are recorded as “Net gain or loss on investments designated at fair value through profit or loss” in the statement of income.

### 2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Investment properties

Investment properties are those held to earn rentals and/or for capital appreciation. These are initially recorded at cost, including acquisition charges associated with the property.

Subsequent to initial recognition, all investment properties are remeasured at fair value and changes in fair value are recognised in the statement of income as gain or loss in investment properties. The fair value of the investment properties is determined either based on valuations made by independent valuers or using internal models with consistent assumptions.

#### Investment reserve

Unrealised gains resulting from revaluation of “investments carried at fair value through profit or loss” and “investment properties” recorded in the statement of income are appropriated to investment revaluation reserve in equity and are not available for distribution to the shareholders. Upon disposal of the “investment carried at fair value through profit or loss” or “investment properties”, the cumulative gains related to the investment is transferred to retained earnings and is available for distribution.

#### Premises and equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment, other than freehold land and capital work-in-progress.

- Computer hardware and software	3-5 years
- Motor vehicle	5 years
- Furniture and office equipments	3 - 5 years
- Leasehold Improvements	Over the lease period

#### Treasury stock

Treasury stock is stated at cost with any gains and losses on sale recognised in equity.

#### Impairment and uncollectability 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 profit rate;
- for assets carried at fair value, impairment is the difference between cost and fair value; and
- for assets carried at cost, impairment is based on present value of future cash flows discounted at the current market rate of return for a similar financial asset.

**2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

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

In addition, a collective provision is made to cover impairment for specific groups of assets where there is a measurable decrease in estimated future cash flows.

**Offsetting**

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

**Employees' end of service benefits**

The Bank provides end of service benefits to its expatriate employees. Entitlement to these benefits is based upon the employees' final salary and length of service, subject to completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

For national employees, the Bank makes contributions to General Organisation for Social Insurance calculated as a percentage of the employees' salaries. The Bank's obligations are limited to these contributions, which are expensed when due.

**Revenue recognition*****Murabaha***

Where the income is quantifiable and contractually determined at the commencement of the contract, income is recognised on a time-apportioned basis over the period of the contract based on the principal amounts outstanding. Where the income from a contract is not quantifiable, it is recognised when realised. Accrual of income is suspended when the Bank believes that the recovery of these amounts may be doubtful or normally when the repayments are overdue by 90 days, whichever is earlier.

***Mudaraba***

Income on Mudaraba transactions are recognised when the right to receive is established or these are declared by the Mudarib, whichever is earlier.

***Dividends***

Dividends from investments in equities, other than those designated as fair value through profit or loss, are recognised when the right to receive the dividend is established.

***Ijarah***

Ijarah Muntahia Bittamleek income is recognised on a time-proportionate basis over the lease term.

***Fees and commission income***

Fees and commission income is recognised when earned.

**2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)*****Fair value of financial assets***

For investments that are traded in organised financial markets, fair value is determined by reference to the prevailing market bid price on the balance sheet date.

For investments where there is no quoted market price, a reasonable estimate of fair value is determined by reference to current market value of another instrument, which is substantially the same, or is based on the assessment of future cash flows. The cash equivalent values are determined by the Bank at current profit rates for contracts with similar terms and risk characteristics.

For investments having fixed or determinable payments fair value is based on the net present value of estimated future cash flows determined by the Bank using current profit rates for investments with similar terms and risk characteristics.

**Foreign currencies**

Foreign currency transactions are recorded at rates of exchange prevailing at the value dates of the transactions. Monetary assets and liabilities in foreign currencies at the balance sheet date are retranslated at market rates of exchange prevailing at that date. Gains and losses arising on translation are recognised in the statement of income. Non-monetary assets that are measured in terms of historical cost in foreign currencies are recorded at rates of exchange prevailing at the value dates of the transactions. Translation gains or losses on non-monetary items classified as "available-for-sale" are included in equity until the related assets are sold or derecognised at which time they are recognised in the statement of income. Translation gains on assets and liabilities classified as "fair value through profit or loss" are directly recognised in the statement of income.

**Trade and settlement date accounting**

Purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Bank commits to purchase or sell the asset.

**Derecognition of financial assets**

A financial asset (in whole or part) is derecognised either when the Bank has transferred substantially all the risks and rewards of ownership or when it has neither transferred nor retained substantially all the risks and rewards and when it no longer has control over the asset or a proportion of the asset.

**Derecognition of financial liabilities**

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

**Fiduciary assets**

Assets held in a fiduciary capacity are not treated as assets of the Bank.

**2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Unrestricted investment account holders (URIA)**

All unrestricted investment accounts are carried at cost less amounts repaid.

**Cash and cash equivalents**

Cash and cash equivalents comprise cash and balances with banks with maturities of less than 90 days from the date of acquisition.

**3 CASH AND BALANCES WITH CENTRAL BANK OF BAHRAIN**

	<b>2006</b>
	<b>BD</b>
Mandatory reserve with Central Bank of Bahrain	930,000
Cash and other balances with Central Bank of Bahrain	505,920
Balances with other banks	1,506,122
	<u>2,942,042</u>

**4 MURABAHA AND MUDARABA WITH BANKS**

	<b>31 December 2006</b>		
	<b>Up to 3 months</b>	<b>3 months to 6 months</b>	<b>Total</b>
	<b>BD</b>	<b>BD</b>	<b>BD</b>
GCC	74,684,215	7,276,100	81,960,315
Arab World	-	7,540,000	7,540,000
Europe	15,589,471	-	15,589,471
	<u>90,273,686</u>	<u>14,816,100</u>	<u>105,089,786</u>

**5 NON-TRADING INVESTMENTS**

	<b>2006</b>
	<b>BD</b>
Quoted	7,914,375
Unquoted	24,704,271
	<u>32,618,646</u>

These represent investments classified as fair value through profit or loss and are carried at fair value.

**6 RECEIVABLES AND PREPAYMENTS**

	<b>2006</b>
	<b>BD</b>
Profit receivable on financing contracts	898,461
Other receivables and prepayments	9,959,493
	<u>10,857,954</u>

Other receivables and prepayments include advance payments amounting to BD 9,613,500 for the acquisition of investments. The related acquisitions and transfers of title to the underlying investments were in the process of being concluded as of the year-end.

**7 UNRESTRICTED INVESTMENT ACCOUNTS**

As unrestricted investment account holders' funds are co-mingled with the banks for investing in short term highly liquid investments and medium term Murabaha, no priority is granted to any party for the purpose of distribution of profits.

According to the terms of acceptance of the unrestricted investment accounts, 100% of the funds are invested on behalf of the customers in short-term commodity Murabaha and as such are classified as "specific investment deposits". For the period ended 31 December 2006, the Bank earned no fee for acting as an agent on these accounts.

**8 SHARE CAPITAL**

	<b>2006</b>
	<b>BD</b>
Authorised	
120,000,000 ordinary shares of BD 1 each	<u>120,000,000</u>
Issued and fully paid:	
120,000,000 ordinary shares of BD 1 each, issued against cash	<u>120,000,000</u>

The founders of the Bank subscribed for 65% of the paid-up capital and the remaining 35% of the shares were offered to the public. The initial public offer for 42 million shares was made at an issue price of BD 1.050 per share, including issue expenses of BD 0.050 per share, in February 2006. The share allotment was completed on 19 March 2006 with the approval of the Capital Markets Supervision Directorate of the CBB and the Bank issued 42,000,000 shares. The allotment process resulted in the Bank purchasing 17,203 shares, being fractional shares, as treasury stock at the issue price. The issue expenses collected on the shares issued were reimbursed to Co-Lead Manager as placement fee as per terms specified in the offering prospectus.

**9 STATUTORY RESERVE**

As required by the Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the net profit for the period has been transferred to the statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve totals 50% of paid up share capital. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

**10 RELATED PARTY TRANSACTIONS**

Related parties comprise major shareholders, directors of the Bank, close members of their families, entities owned or controlled by them and companies affiliated by virtue of common ownership or directors with that of the Bank. The transactions with these parties were made on commercial terms.

The significant balances with related parties at 31 December 2006 were as follows:

	2006			
	Joint Ventures	Directors & Related Entities	Senior Management	Total
	BD	BD	BD	BD
<b>Assets</b>				
Murabaha financing	-	1,221,011	39,447	1,260,458
Ijarah Muntahia Bittamleek	-	4,800,884	-	4,800,884
<b>Liabilities</b>				
Customer current accounts	361,711	-	-	361,711
Unrestricted investment accounts	4,332,436	9,052,950	-	13,385,386

The income and expenses in respect of related parties included in the financial statements are as follows:

<b>Income</b>				
Income from other Islamic financing contracts	-	158,553	223	158,776
Fees and commission	-	21,101	-	21,101
<b>Expenses</b>				
Share of profit to unrestricted investment account holders	63,099	65,630	-	128,729

In addition to the above, income from Murabaha and Mudaraba received from related parties included a profit of BD 3.77 million which was earned and received through the co-lead manager, a related party, in connection with investments made by the related party on behalf of the Bank using the IPO proceeds.

Compensation of key management personnel, consisting solely of short-term benefits, paid during the year was BD 1,229,200.

**11 COMMITMENTS****Undrawn financing commitments**

The Bank has a contracted commitment expiring in 2007 aggregating to provide finance for BD 2,790,779 which remained undrawn as at the year end. In addition, the Bank had an undrawn capital

**11 COMMITMENTS (continued)**

commitment of BD 2,008,000 as of 31 December 2006 on account of investments. Commitments generally have fixed expiration dates, or other termination clauses. Since commitment may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

**Operating lease commitment - Bank as lessee**

The Bank has entered into a five-year operating lease for its headquarters premises. Future minimal rentals payable under the non-cancellable lease as at 31 December 2006 are as follows:

	BD
Within 1 year	322,328
After one year but not more than five years	978,984
	<b>1,301,312</b>

**12 CREDIT RISK****Risk management**

Credit risk is the risk that one party to a financial contract will fail to discharge an obligation and cause the other party to incur a financial loss. The Bank controls credit risk by monitoring credit exposures and continually assessing the creditworthiness of counterparties.

**Type of credit risk**

Various contracts entered into by the Bank comprise Murabaha receivables, Mudaraba investments and Ijarah Muntahia Bittamleek contracts. Murabaha receivables contracts cover land, building materials, motor vehicles and others. Mudaraba investments consist of financing transactions entered through other Islamic banks and financial institutions. The various financial instruments are:

***Murabaha receivables***

The Bank arranges Murabaha transactions by buying a commodity (which represents the object of the Murabaha) and then selling this commodity to customers (beneficiary) after adding a margin of profit over the cost. The sale price (cost plus profit margin) is repaid in installments over the agreed period.

***Mudaraba investments***

Mudaraba investments is a partnership where the Bank, as an investor ("Rab Al-Mal"), gives money to the investee ("Mudarib") for investing for a definite period of time.

***Ijarah Muntahia Bittamleek***

The legal title of the leased asset under Ijarah Muntahia Bittamleek passes to the lessee at the end of the Ijarah term, provided that all Ijarah installments are settled and the lessee purchases the asset.

**13 CONCENTRATION**

Concentration arises when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentration indicates the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographic location. The Bank manages its credit risk exposure through diversification of financing activities to avoid undue concentrations of risks with customers in specific locations or businesses.

The distribution of assets, liabilities and unrestricted investment accounts by geographic region and industry sector was as follows:

	Assets	Liabilities, Unrestricted Investment Accounts & Equity
	2006 BD	2006 BD
<b>Geographic Region</b>		
GCC	153,948,549	48,318,047
Arab World	17,250,408	-
Europe	16,581,353	3,338,900
Asia	255,606	-
America	22,620	-
	188,058,536	51,656,947
Equity	-	136,401,589
	188,058,536	188,058,536
<b>Industry Sector</b>		
Trading and manufacturing	6,668,012	3,225,972
Banks and financial institutions	122,256,947	38,716,628
Real estate	51,992,775	6,787,056
Aviation	4,800,884	-
Individuals	39,446	115,661
Others	2,300,472	2,811,630
	188,058,536	51,656,947
Equity	-	136,401,589
	188,058,536	188,058,536

**14 MARKET RISK**

Market risk arises from fluctuations in global yields on financial instruments and foreign exchange rates that could have an indirect effect on the Bank's assets value and equity prices. The Board has set limits on the risk that may be accepted. This is monitored on a regular basis by the Asset and Liability Committee of the Bank.

**15 EQUITY PRICE RISK**

Equity price risk arises from fluctuations in equity prices. The Board has set limits on the amount and type of investments that may be accepted. This is monitored on an ongoing basis by the Bank's Investment Committee.

**16 PROFIT RETURN RISK**

As an Islamic institution, the Bank has exposure to fluctuations in the income on its assets and cost of its liabilities. The Bank recognises income on certain financial assets on a time-apportioned basis. The Bank has set limits for profit return risk.

The following table indicates the gaps in the profit rate profile at the balance sheet date and the effective yield/cost, set out as a percentage of principal, of assets/liabilities on which income is generated or profit is payable.

The Bank's profit sensitivity position based on contractual repricing arrangements or maturity at 31 December 2006 has been shown in the following table:

## 16 PROFIT RETURN RISK (continued)

	Up to 3 Months	3 Months to 1 Year	1 to 5 Years	Not Exposed to Profit Rate Risk	Total	Effective Profit Rates
	BD	BD	BD	BD	BD	
<b>ASSETS</b>						
Cash & balances with Central Bank of Bahrain	2,942,042	-	-	-	2,942,042	-
Murabaha & Mudaraba with banks	90,273,686	14,816,100	-	-	105,089,786	5.28%
Murabaha financing	3,073,000	10,088,261	9,802,006	-	22,963,267	8.20%
Ijarah Muntahia Bittamleek	2,175,236	3,843,400	4,363,793	-	10,382,429	8.45%
Non-trading investments	-	-	32,618,646	-	32,618,646	-
Investment in properties	-	-	-	1,177,528	1,177,528	-
Receivables and prepayments	996,431	9,861,523	-	-	10,857,954	-
Premises and equipment	-	-	-	2,026,884	2,026,884	-
	<u>99,460,395</u>	<u>38,609,284</u>	<u>46,784,445</u>	<u>3,204,412</u>	<u>188,058,536</u>	
<b>LIABILITIES &amp; UNRESTRICTED INVESTMENT ACCOUNTS</b>						
Murabaha from banks	23,647,305	-	-	-	23,647,305	5.26%
Customers' current accounts	5,673,812	-	-	-	5,673,812	-
Other liabilities	2,223,863	-	-	-	2,223,863	-
<b>UNRESTRICTED INVESTMENT ACCOUNTS</b>	<b>20,111,967</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>20,111,967</b>	<b>5.20%</b>
	<u>51,656,947</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>51,656,947</u>	
Profit pricing gap	<u>47,803,448</u>	<u>38,609,284</u>	<u>46,784,445</u>	<u>3,204,412</u>	<u>136,401,589</u>	
Cumulative profit pricing gap	<u>47,803,448</u>	<u>86,412,732</u>	<u>133,197,177</u>	<u>136,401,589</u>		

## 17 CURRENCY RISK

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on positions by currency. Positions are monitored on a periodic basis to ensure positions are maintained within established limits.

Substantial portion of the Bank's assets and liabilities are denominated in Bahraini Dinars or US Dollars. The Bank had the following significant net exposures denominated in foreign currencies as of 31 December 2006:

	2006 BD
US Dollars	57,231,592
Saudi Riyals	8,705,404

## 18 LIQUIDITY RISK

Liquidity risk is the risk that the Bank will be unable to meet its liabilities as they fall due. Liquidity risk can be caused by market disruptions or credit downgrades which may impact certain sources of funding. To mitigate this risk, management has diversified funding sources and assets are managed with liquidity in mind, maintaining an adequate balance of cash and cash equivalents.

The table below summarizes the maturity profile of the Bank's assets and liabilities based on remaining contractual repayment arrangements. Maturity periods for investments are based on expected exit dates.

## 18 LIQUIDITY RISK (continued)

The maturity profile of assets and liabilities as at 31 December 2006 is as follows:

	Up to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
	BD	BD	BD	BD	BD
<b>ASSETS</b>					
Cash & balances with Central Bank of Bahrain	2,942,042	-	-	-	2,942,042
Murabaha and Mudaraba with banks	90,273,686	14,816,100	-	-	105,089,786
Murabaha financing	3,073,000	11,428,760	8,461,507	-	22,963,267
Ijarah Muntahia Bittamleek	354,774	534,408	9,493,247	-	10,382,429
Non-trading investments	-	-	32,618,646	-	32,618,646
Investment properties	-	-	-	1,177,528	1,177,528
Receivables and prepayments	996,431	9,861,523	-	-	10,857,954
Premises and equipment	-	-	2,026,884	-	2,026,884
	<u>97,639,933</u>	<u>36,640,791</u>	<u>52,600,284</u>	<u>1,177,528</u>	<u>188,058,536</u>
<b>LIABILITIES &amp; UNRESTRICTED INVESTMENT ACCOUNTS</b>					
Murabaha from banks	23,647,305	-	-	-	23,647,305
Customers' current accounts	5,673,812	-	-	-	5,673,812
Other liabilities	2,223,863	-	-	-	2,223,863
	<u>20,111,967</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>20,111,967</u>
	<u>51,656,947</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>51,656,947</u>
Liquidity gap	<u>45,982,986</u>	<u>36,640,791</u>	<u>52,600,284</u>	<u>1,177,528</u>	<u>136,401,589</u>
Cumulative liquidity gap	<u>45,982,986</u>	<u>82,623,777</u>	<u>135,224,061</u>	<u>136,401,589</u>	

## 19 SEGMENT INFORMATION

## Primary segment information

For management purposes, the Bank is organised into four major business segments:

*Commercial Banking*

principally managing Shari'a compliant profit sharing investment accounts, and offering Shari'a compliant financing contracts and other Shari'a-compliant products. This segment comprises corporate banking, retail banking and private banking and wealth management. As of the year-end, retail banking and private banking and wealth management were in the process of being launched.

*Treasury*

principally handling Shari'a-compliant money market, trading and treasury services including short-term commodity Murabaha.

*Investments*

principally the Banks' proprietary portfolio and serving clients with a range of investment products, funds and alternative investments.

*Capital*

manages the undeployed capital of the bank by investing it in high quality financial instruments, incurs all expenses in managing such investments and accounts for the capital governance related expenses.

These segments are the basis on which the Bank reports its primary segment information. Transactions between segments are conducted at estimated market rates on an arm's length basis. Transfer charges are based on a pool rate which approximates the cost of funds.

Segment information for the period 19 January 2006 to 31 December 2006 was as follows:

	Commercial Banking	Treasury	Investments	Capital	Total
	BD	BD	BD	BD	BD
Operating income	846,293	1,022,217	11,438,388	7,552,000	20,858,898
Segment result	<u>26,546</u>	<u>44,901</u>	<u>10,634,405</u>	<u>5,712,940</u>	<u>16,418,792</u>
<b>Other Information</b>					
Segment assets	<u>30,815,622</u>	<u>19,534,393</u>	<u>46,566,958</u>	<u>91,141,563</u>	<u>188,058,536</u>
Segment liabilities,	<u>26,043,987</u>	<u>23,712,259</u>	<u>327,435</u>	<u>137,974,855</u>	<u>188,058,536</u>

**19 SEGMENT INFORMATION (continued)****Secondary segment information**

The Bank primarily operates in the GCC and derives substantially all its operating income and incurs all operating expenses in the GCC.

**20 FIDUCIARY ASSETS**

Funds under management at the year-end amounted to BD 22,041,590. These assets are held in a fiduciary capacity and are not included in the balance sheet.

**21 SHARI'A SUPERVISORY BOARD**

The Bank's Shari'a Supervisory Board consists of four Islamic scholars who review the Bank's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Bank to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

**22 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A**

The Bank did not receive income or incur any expense prohibited by the Shari'a.

**23 SOCIAL RESPONSIBILITY**

The Bank discharges its social responsibility through Zakah, charity fund expenditures and donations to the good faith qard fund which is used for charitable purposes. During the period the Bank incurred an amount of BD 8,274 on account of charitable donations.

**24 ZAKAH**

In accordance with the instructions of the Shari'a Supervisory Board of the Bank, payment of Zakah is the responsibility of the shareholders of the Bank. Accordingly, no Zakah has been charged in these financial statements.

**25 CAPITAL ADEQUACY**

The risk assets ratio calculations, in accordance with the capital adequacy guidelines of the CBB are as follows:

		<b>2006</b>
		<b>BD</b>
Capital Base (Tier 1)	(A)	136,401,589
Credit risk weighted exposures		99,334,000
Market risk weighted exposures		66,213,000
Total risk weighted exposure	(B)	<u>165,547,000</u>
Capital adequacy	(A ÷ B)	<u>82.4%</u>
Minimum requirement		<u>12%</u>