BBK بنك البحرين والكويت

Annual Report

2004

H.M. King Hamad bin Isa Al Khalifa
King of Bahrain

H.H. Shaikh Jaber Al Ahmed Al Sabah
The Amir of the State of Kuwait

Contents

Our Vision

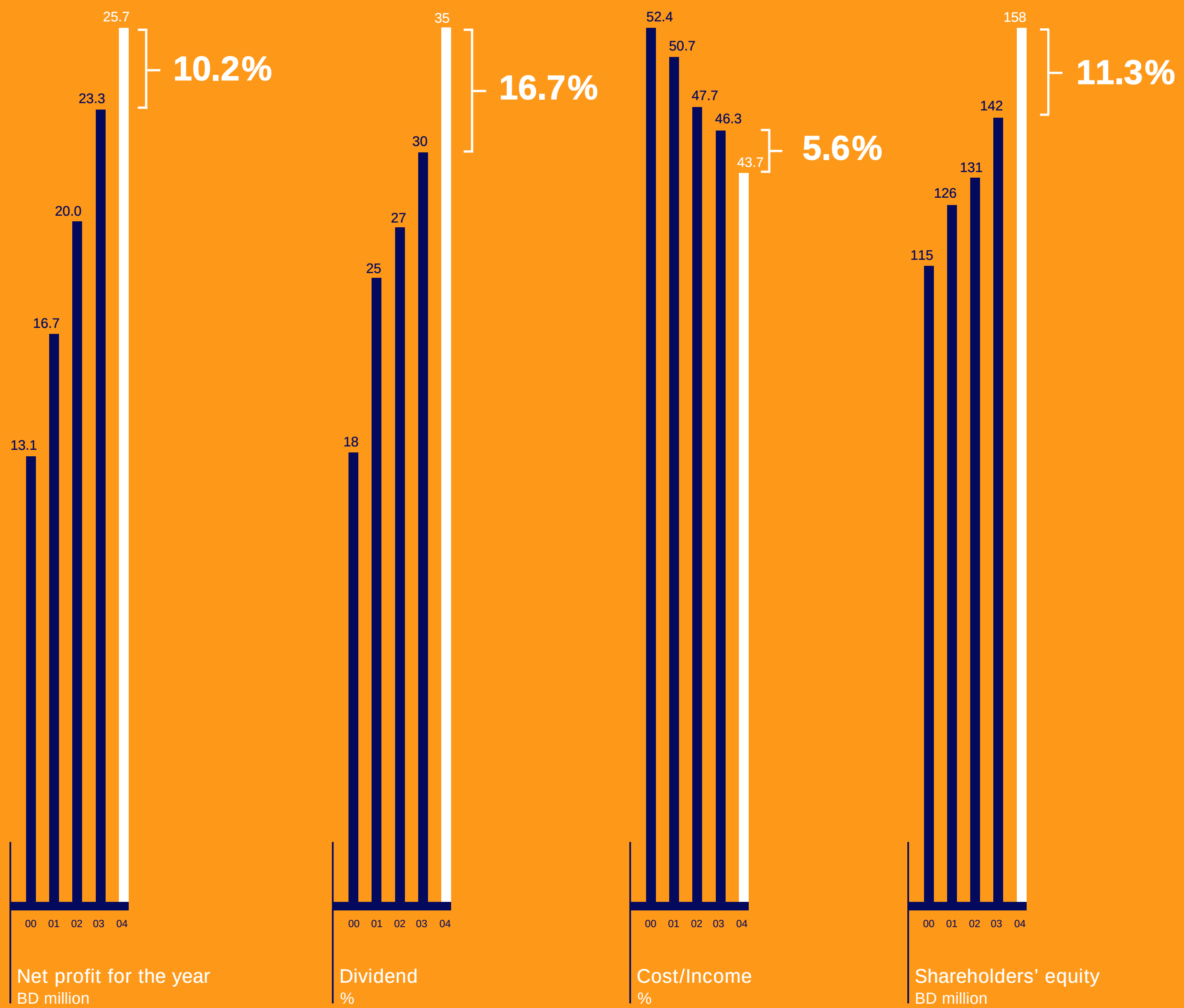
Bank of Bahrain and Kuwait will be the premier regional financial services enterprise in providing superior products and services of high quality through innovation, technology and ‘life long’ customer relationships.

The Bank will expand its overseas presence in more locations in which it chooses to operate in order to satisfy the diversified needs of customers. We believe customers are the driving force in everything we do. We will not compromise on our absolute commitment to providing the very best in customer service.

We believe our people are our number one asset with the highest degree of competence, integrity and professionalism. We instill in our people the principles of entrepreneurship, decision-making and ownership through our commitment to training, development, delegation and performance based reward systems.

We are determined to utilise ‘cutting edge’ technology which we recognise as most critical in supporting our short, medium and long-term business objectives.

Our shareholders are the source of our financial strength and can expect continued growth and profitability. They are supportive and are confident of our vision of the future.



25.7
10.2%
23.3
20.0
16.7
13.1
00 01 02 03 04
Net profit for the year
BD million
35
16.7%
30
27
25
18
00 01 02 03 04
Dividend
%
52.4
50.7
47.7
46.3
43.7
5.6%
00 01 02 03 04
Cost/Income
%
158
11.3%
142
131
126
115
00 01 02 03 04
Shareholders' equity
BD million

Financial Highlights

	2000	2001	2002	2003	2004
Income Statement Highlights BD millions					
Net interest income	20.8	23.7	25.5	26.1	29.5
Other income	11.2	13.6	16.2	21.4	23.6
Operating expenses	16.8	18.9	19.9	22.0	23.2
Net profit for the year	13.1	16.7	20.0	23.3	25.7
Dividend	18%	25%	27%	30%	35%
Financial Statement Highlights BD millions					
Total assets	1,059	1,101	1,215	1,314	1,421
Net loans	499	481	537	659	765
Investments	318	328	386	415	407
Deposits	847	873	985	1,064	1,146
Term loans	75	85	85	38	–
Medium term deposits from banks	–	–	–	47	94
Shareholders’ equity	115	126	131	142	158
Profitability					
Earnings per share – fils	23	30	35	41	45
Cost / income	52.40%	50.70%	47.70%	46.30%	43.70%
Return on average assets	1.22%	1.50%	1.66%	1.83%	1.83%
Return on average equity	12.00%	14.40%	16.10%	17.80%	17.80%
Profit per employee (BD)	18,960	24,117	28,341	32,739	36,578
Capital					
Capital adequacy	17.30%	17.10%	16.80%	16.73%	18.82%
Shareholders' equity / Total assets	10.90%	11.40%	10.80%	10.80%	11.10%
Debt / equity	65.60%	67.40%	64.70%	59.63%	59.73%
Liquidity and Business Indicators					
Loans & advances / Total assets	47.20%	43.70%	44.20%	50.20%	53.80%
Investments excluding T bills / Total assets	28.40%	26.40%	26.00%	25.70%	26.47%
Liquid assets / Total assets	41.40%	31.60%	34.10%	32.40%	29.49%
Non inter-bank deposits / Loans & investments	85.40%	95.40%	87.10%	86.04%	82.28%
Net interest margin	2.27%	2.41%	2.45%	2.30%	2.29%
Number of employees	692	694	706	712	702

Performance Highlights

10.2% Net profit growth, to BD 25.7 million

8.2% Increase in balance sheet

43.7% Cost to income ratio (improved from 46.3% in 2003)

Strongest financial performance in BBK's history, with a healthy rise in all key indicators, including a 10.2% increase in net profit to BD 25.7 million.

Total assets now stand at BD 1,421 million, an 8.2% increase over 2003.

Cost to income ratio improved once again, from 46.3% in 2003 to 43.7% in 2004.

35% dividend payment for 2004, reflecting an increase of 133% over five years.

US$ 125 million medium term credit facility successfully arranged through 14 regional and international banks.

Successfully launched a new 'smart' credit card.

Broadened BBK's range of online services, including real time payment of telephone bills, purchase of Secura insurance and Al-Hayrat certificates.

Introduced a new Employees Performance Management System, recognising and rewarding individual achievement and strengthening the Bank's succession planning process.

BBK was the first Bahraini bank to receive a special GCC award for its Bahrainisation achievement.

Chairman's Statement

Dear Shareholders

On behalf of the Board of Directors, I have the pleasure to present the 33rd annual report and consolidated financial statements of Bank of Bahrain and Kuwait (BBK) for the year ended 31 December 2004. Without doubt, this was another successful year for your Bank, highlighted by record financial performance, sound strategic progress, continued operational success, and growing external recognition.

Mr Murad Ali Murad
Chairman

Financial performance

In 2004, BBK recorded its highest ever net profit of BD 25.7 million, an increase of 10.2% over the previous year. This includes a one-off contribution of BD 2.92 million from the sale of part of the Bank's strategic investments. Total assets grew by 8.2% to BD 1,421 million, confirming BBK's status as the largest commercial bank in Bahrain for the fifth successive year. The Bank's consolidated profit has resulted in a consistent return on shareholders' equity at 17.8%. The market capitalisation of BBK stood at the end of the year at BD 413 million and its share price also increased to 725 fils at the end of 2004, compared to 545 fils at the end of 2003, further increasing the value of our shareholders' investment.

It is also worth noting that BBK's share price appreciated by 33% during the year, compared with the rise in the Bahrain Stock Market Index of 30%.

I am pleased to report that BBK's sustained financial performance has been recognised by an increase in the Bank's Foreign Currency and Long Term Sovereignty ratings by Moody's and Capital Intelligence. In addition, in July 2004, we successfully mandated Arab Banking Corporation, Barclays Capital, Citibank, NBK and Sumitomo Mitsui to arrange a US$ 100 million credit facility. The positive response by 14 regional and international banks resulted in an increased medium term facility of US$ 125 million with tenor of five years at a very competitive rate, and set a new benchmark for the local market.

Overall, this is a significant achievement, given the increased competitiveness of the domestic and regional markets, and the continued volatility of the global economy over the last twelve months. However, these factors were offset by the positive effect on the regional economy by the dramatic rise in the price of oil, which breached the US$ 50 mark for the first time. The increased money supply and liquidity provided a boost for investment in new infrastructure and industrial projects in Bahrain, with greater participation by the private sector.

New developments such as the Financial Harbour and World Trade Centre (WTC) Towers will further enhance the Kingdom's status as a leading regional financial and business centre. However, long-term growth cannot be sustained without major structural changes and reforms in a number of sectors of the economy. These sectors include the labour market, education and training, and growing the economy. The Bank welcomes the recent initiatives to address some of these issues, and will actively support all measures that bring about their speedy and effective implementation.

Strategic direction

Good progress was made in 2004 towards implementing BBK's current 2003-2005 three-year strategic plan. The focus of the strategy is to build upon our strong financial position, continue to diversify our business, and to strengthen our leadership in banking services based on technology. Two key objectives are to increase the return on shareholders' equity to 20 per cent by the end of 2005, and to enhance the ratio of gross income to operating expenses. We will also continue to identify and study further strategic alliances, as well as the opportunity of mergers and acquisitions, in order to establish cost efficiencies and diversify our assets and revenues.

During the year, the Board of Directors and Management continued their strategic review of BBK's operations in India, as well as the future direction of two subsidiaries – BBK Financial Services and Al-Khaleej Islamic Investment Bank – in line with changing market conditions. We also reviewed plans for the further development of the Bank's insurance and Islamic banking activities, both of which offer new opportunities for diversification and growth. In this respect, it is hoped that the long-awaited enactment of Bahrain's new Central Bank Law will take place during 2005.

A key strategic achievement in 2004 was the considerable work done to launch BBK's corporate rebranding which is expected to be implemented in 2005. Over the last thirty-three years, BBK has developed into a dynamic, innovative and responsive financial enterprise, with a growing regional presence. Our new bright and contemporary visual identity reflects this change, and also communicates BBK's vision of a bright future for all our stakeholders. During 2005, it will be used to spearhead the introduction of our new and innovative retail banking concept, which will focus on customer service as the key competitive differentiator rather than products and services.

Corporate governance

BBK welcomes the disclosure standards introduced in 2004 by Bahrain Monetary Agency and their initiatives on corporate governance, guidelines on insiders and revised anti money laundering regulations that are being introduced from 2005 for the Kingdom's banks and listed companies. Such a move will no doubt help to preserve Bahrain's reputation as a well regulated financial centre in the region, operating in accordance with the highest international standards.

In this regard, a code of conduct for the Board of Directors was introduced and signed by each member of the Board.

Also, I would like to emphasise that we have made every endeavour to comply with all current BMA disclosure standards in this year's annual report and consolidated financial statements. In addition, we continued to strengthen our corporate governance during 2004, including the creation of a new Compensation Committee of the Board of Directors and the strengthening of the compliance function. Such measures are designed to keep us at the forefront of transparency and good corporate governance in the region.

We also welcome the BMA's plans to establish a new Credit Reference Bureau (CRB) for Bahrain in 2005. This will mean that financial institutions will be in a better position to provide credit to their customers. The CRB will help in setting healthy parameters for banks and financial institutions to continue the self-regulation of their retail lending business. The retail sector of the banking industry is extremely vital for the economy and has contributed to its growth in a number of ways, and it is hoped that this sector will continue its activities based on supply and demand of the market and without additional restrictions and constraints. Such initiatives will no doubt help to preserve Bahrain's reputation as a well regulated financial centre in the region, operating in accordance with the highest international standards.

Operational achievements

Throughout 2004, BBK continued to lead the way with new and innovative products and services for our retail, corporate, treasury, and investment clients. We further enhanced our successful consumer and mortgage loans, introduced a new 'smart' credit card, and launched another exclusive real estate investment fund.

In addition, we made more products and services available online, such as real time payment of telephone bills, and the purchase of Secura insurance products and Al-Hayrat savings certificates. We also continued to provide financing for a range of industrial, commercial and infrastructural projects, including the latest Alba pot line expansion and the refinery modernisation for Bapco.

A key achievement during the year was the development of our new Information Technology infrastructure, representing a major strategic investment of BD 1.7 million. BBK's new core banking and branch automation systems, which will be implemented during 2005, will have a profound effect on improving our operating efficiency and customer service levels. At the same time, we continued to strengthen the Bank's financial control and planning procedures, and to streamline our internal processes.

Recognising that our people are BBK's most important assets, we continued to place utmost priority on their professional development. The Bank's new Performance Management System was introduced in 2004. As well as recognising and rewarding individual performance, it will also strengthen BBK's succession planning process. It was also encouraging to see the first group of graduates in our new Management Trainees Programme complete their initial training and take up permanent positions throughout the Bank. This innovative programme is now regarded as a role model for the industry. The Bank's successful track record for recruiting and retaining Bahraini nationals was also recognised during the year. BBK became the first Bahraini bank to receive a special GCC award for the employment of nationals by regional private sector companies.

Appreciation

On behalf of the Board of Directors, shareholders and staff, I would like to express my best wishes to His Majesty King Hamad bin Isa Al Khalifa, the King of Bahrain, and to His Highness Shaikh Jaber Al Ahmed Al Sabah, the Amir of Kuwait, and extend my gratitude to their governments and regulatory authorities for their continued support to the Bank.

I am pleased to announce that a Royal Decree was issued in January 2005 to appoint Board member His Excellency Mr. Rasheed Mohammed Al-Maraj as the Governor of Bahrain Monetary Agency. I would like to take this opportunity on behalf of the Board of Directors and all the staff to wish him well and thank him for his contribution during his term as a member of the Board of Directors of the Bank. I would also like to take this opportunity to thank Mr. Fouad Ismail Dashti and Mr Esam Abdul Aziz Al Osaimi for their contribution during their directorship in the Board which ended during the year and welcome the incoming Board member Mr. A. Majeed Haji Al Shatti wishing him all the success.

I would also like to take this opportunity to convey our thanks to our shareholders for their confidence in the Board of Directors and management and their continued financial support for the Bank; to our loyal customers for their continued trust; and to all our staff at home and abroad, whose dedication and hard work have contributed to another successful year for BBK.

Murad Ali Murad
Chairman

13%

Increase in customer loans portfolio

The new consumer loans package, introduced in 2003, was further enhanced with more flexible repayment options. The residential mortgage loans package was also enhanced with added features in order to reinforce its position in the market.

Board of Directors

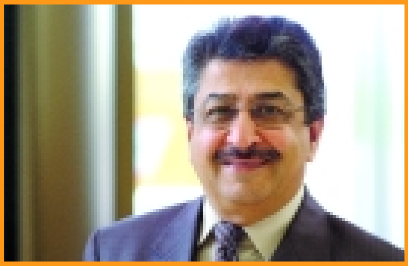
Murad Ali Murad
Chairman

Rasheed Mohammed Al-Maraj
Director

Yacuob Yousef Al Fulaij
Director

Jassem Hasan Ali Zainal
Deputy Chairman

Hamad Ahmad Al Busairi
Director



Mohammed Salahuddin
Director

Abdulla Mohammed Al Sumait
Director

Saeed A. Karim Al-Marzooq
Director

Shaikh Mohammed bin Isa Al Khalifa
Director

Abdul Majeed Haji Al Shatti
Director

Aref Saleh Khamis
Director

Management Review

I am pleased to report that BBK enjoyed yet another successful year in 2004. The Bank's financial performance and operational achievements continued to enhance our reputation, not only as the leading client-focused bank in the Kingdom, but also as the preferred employer of Bahraini nationals in the private sector.

We achieved healthy profits, grew our asset base, and maintained a consistent return on shareholders' equity. At the same time, we significantly strengthened the Bank's operating infrastructure and improved our services by enhancing the range of innovative delivery channels.

Dr Farid Ahmed Al Mulla
General Manager Chief Executive Officer

Underlying BBK's promise of a bright future for all stakeholders is our approach to banking that places the emphasis on people and performance. Our objective is to make BBK the best place to work, so that our staff, supported by efficient processes and cutting edge technology, make BBK the best bank for clients. Such a partnership will help to ensure strong financial performance and a superior return to our shareholders.

The success of this approach was illustrated by BBK's achievements during 2004. These were the direct result of management and staff from different parts of the Bank working closely together as one team. Such a pervading spirit of cooperation throughout the year resulted in BBK becoming a stronger, more efficient, and more responsive financial enterprise.

Dr Farid Ahmed Al Mulla
General Manager Chief Executive Officer

Operational achievements

Staff

As the human face of the Bank, our people inspire trust and confidence in our clients, helping to build lasting and mutually beneficial relationships. This is why we place importance on ensuring their personal welfare and professional development.

During 2004, the first group of graduates in the new BBK Management Trainees Programme completed their initial training and took up permanent positions throughout the Bank. The success of this innovative programme, with its exacting entry criteria and challenging development curriculum, has attracted wide spread industry recognition.

Also during the year, a new Performance Management System was introduced for all staff. This important people initiative provides a competency framework that recognises and rewards individual performance. The strategic aim is to build a cadre of well-qualified professionals that will form a foundation for a structured succession planning process.

The Bank's longstanding commitment to providing talented Bahrainis with excellent career opportunities was recognised during 2004 by a special award from the executive office of the General Assembly of the GCC. BBK became the first Bahraini bank to be honoured for its outstanding achievements in the employment of nationals by the private sector which stands at 95%.

95%

Bahrainisation level

BBK became the first Bahraini bank to be honoured by the GCC Ministers of Labour and Social Affairs for its outstanding achievements in the employment of nationals by the private sector.

50%

Increase in number of insurance transactions

The Bank successfully expanded its insurance business with Secura car and home insurance products, provided in association with Bahrain Kuwait Insurance Company, showing an increase of 45% in premium income.

Customers

To meet the challenges posed by the increasingly competitive domestic **retail banking** environment during 2004, BBK continued to focus on exceeding clients' expectations for a comprehensive range of innovative products, services and delivery channels.

The new consumer loans package, introduced in 2003, was further enhanced with more flexible repayment options, and a dedicated promotions campaign for this product resulted in the Bank's customer loans portfolio increasing by over 13% during the year. The residential mortgage loans package was also enhanced with added features in order to reinforce its position in the market.

The Bank successfully expanded its insurance business, with Secura car and home insurance products, provided in association with Bahrain Kuwait Insurance Company, showing an increase of 45% in premium income, while the number of transactions grew by 50%. The exclusive provision of Western Union money transfers by BBK branches was well received by clients, with transaction volumes growing by 23%.

BBK is committed to remaining at the forefront of **electronic banking**. New services introduced during the year resulted in a 34% utilization in Internet home banking of BBK and third party e-channels. The number of client transactions conducted electronically now exceeds 800,000 transactions, excluding those through ATMs.

New services include the Batelco and MTC e-Service for online real time bill payments, Direct Debit e-Service, and e-Hayrat for the purchase of Al Hayrat savings certificates online. These complement BBK's existing innovative services such as BahrainPay electronic payment gateway, enterActive loan, mBank (WAP banking services), SMSBank, and e-Bank Corporate.

A major dynamic upgrade of BBK's web portal (dot.) was launched in 2004. This encompasses the products and services from BBK and third parties in a user-friendly environment. Features include MyBBK where customers and non-customers can participate in discussion groups and forums, create online communities, and personalise their own pages on the website. It also features enhanced navigator tools and helpful services such as greeting e-cards and prayer times.

In addition, BBK's eCall Centre has become one of most sophisticated and comprehensive centres of its kind in Bahrain by introducing its web channels, email, fax, call-back and FAQ. The successful take up of this service was illustrated by the results of an independent confidential customer satisfaction survey.

Through its wholly-owned subsidiary, Credimax, BBK continued to maintain its leading position in the **cards service** sector in Bahrain, despite increasing competition from several new entrants during the year. New initiatives include the introduction of the first proprietary chip card (smart card) from a financial institution in Bahrain, the signing of an exclusive agreement with Japan Card Bureau, and the launch of a specially designed credit card to celebrate the occasion of the first Formula One grand prix in the Middle East. In addition, Credimax is about to form a third party processing company in partnership with a leading technology provider.

As one of the largest providers of **corporate banking** services in the Kingdom, BBK continued to play a leading role in supporting Bahrain's economic growth and industrial diversification. The Bank's participation in industrial, commercial and infrastructural projects included major financing for the latest Aluminium Bahrain (Alba) expansion plans.

International banking activities during the year focused on boosting fee-based income and actively seeking additional trade finance, structured asset financing and credit derivatives transactions. The Bank also participated in a number of corporate finance transactions across the GCC region, especially in the oil, gas and petrochemical sectors.

A record profit was posted by the Bank's **treasury services** in 2004. BBK continued to implement a sound liquidity policy in order to achieve stable profitability through reducing Forex and money market risk, and creating an environment in which inter-bank and corporate business could flourish.

During 2004, BBK repositioned its **investment services**, realigning its global markets, capital markets and advisory activities to better meet the increasingly sophisticated and inter-related needs of its clients, while continuing to increase fee-based income. Continuing its move towards cash yield products, BBK launched a third exclusive real estate fund in association with Kuwait Financial Centre (Markaz). This constitutes a unique and innovative real estate investment offering from a commercial bank in Bahrain, comprising residential, office and retail property developments.

The requirements of the Bank's **overseas** clients continued to be well serviced by BBK's branches in Kuwait and India, together with its representative office in Dubai.

BBK's **Kuwait** branch performed with distinction during 2004, taking advantage of buoyant local and regional market conditions and achieving a substantial increase in overall activity. The branch introduced new competitive consumer loans to meet local demand, and achieved a growth of 29% in private deposits. In addition, it continued to build its corporate loan portfolio, resulting in a growth of over 30%.

In **India**, BBK's Mumbai and Hyderabad branches were affected by the high rise in interest rates and inflation that reflected on the entire banking sector during 2004. However, BBK identified new opportunities in both corporate and retail banking, introducing securitization of rent and credit card receivables, and extending buyers' credit on imports to India. A new insurance-linked deposit product – BBK Life Line – was introduced for NRIs in the Gulf – in association with the National Insurance Company. The Bank also boosted fee income by becoming a referral agent of Aviva Insurance Company and National Insurance Company for life and non-life insurance products respectively.

The Bank's representative office in **Dubai** enjoyed a year of increased business activity. Average assets sourced in the UAE increased by 92%, while total net interest income grew by 120%. BBK increased its participation in key project financing transactions, including high profile projects such as the Dolphin Energy gas transportation initiative between the State of Qatar, the UAE and the Sultanate of Oman; and the Etisalat mobile phone consortium in the Kingdom of Saudi Arabia. Important new corporate business was also secured with a number of leading companies across various sectors of the UAE economy.

Community

BBK has always recognised its responsibility to contribute to the social well being of Bahrain's society. To date, over BD 3 million has been donated in support of the local community with financial support for numerous charitable, medical, scientific, cultural, sporting and social institutions and organisations. The Bank's staff is also closely involved in community activities. These are organised by BBK's Staff Social Committee – which initiated events involving Bank employees and their families with local charities and worthwhile causes.

Internal processes

BBK's new strategy, implemented in 2003, defined the value addition role of **financial control and planning** and during 2004 this was further evidenced by a number of initiatives. BBK was one of the first banks in Bahrain to introduce the concept of risk-adjusted return on capital (RAROC), which is a sophisticated tool for measuring the profitability of customers against associated risk exposures. In line with best market practice, the concept of matched funds transfer pricing (FTP) was further refined, helping to determine the actual profitability of each business unit. The Bank's customer profitability analysis continued to be enhanced and is currently being extended to BBK's overseas branches.

Eradicating inefficiencies in banking, **operations** is a key strategic objective of BBK, in order to establish cost efficiencies and improve customer service. In 2004, the Bank completed the implementation of a fully automated Trade Finance System. This will not only help to increase productivity but also enhance client satisfaction, thereby providing an important competitive edge. The new system incorporates FaxMaker, which automatically informs customers when their LCs have been processed.

Straight through processing (STP) is another key objective in achieving operational effectiveness. During 2004, STP was implemented for trade finance, treasury, and investment advisory activities and good progress was made in applying it to inward remittances, standing orders, and salary processing for corporate clients. New processes were also introduced in 2004 to meet the revised BMA regulations for faster and more timely clearing of cheques.

Technology

Supported by a strategic investment of BD 1.7 million, BBK initiated the implementation of new core banking and branch automation systems during 2004. These major IT infrastructural developments will provide significant benefits – to the Bank in terms of operational agility and efficiency – and to clients in the form of new sophisticated products and delivery channels, and enhanced levels of service.

Another important IT development during the year was the introduction of InfoGate – the Bank's new information gateway. This will speed BBK's transition to a 'smart enterprise' through the provision of an intelligent information resource, which will improve management reporting, and enable faster and easier sharing of information by all staff.

In a first for Bahrain's private sector, BBK launched a pilot project in 2004 to enable wireless communications between the head office and branches. This alternative to a traditional lease line provides a multiple of 35 in improved bandwidth, reducing communications costs and improving speed, reliability and security. Wireless networking has also been introduced within the Bank's head office.

34%

Utilization in internet home banking of BBK and third party e-channels
BBK is committed to remaining at the forefront of electronic banking. The number of client transactions conducted electronically now exceeds 800,000 transactions, excluding those through ATMs.

Executive Management

Dr Farid Ahmed Al Mulla

Ahmed Al Banna

Jamal Mohammed Hijres

Dr Khalid Abdulla

Abdul Hussain Bustani

Abdulla Abdulrahman Hussain

Abdul Karim Ahmed Bucheery

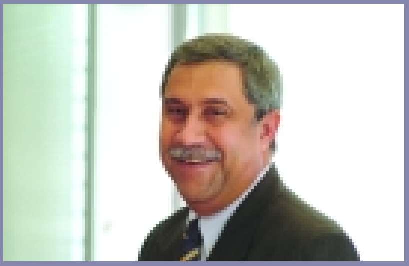
Amit Kumar

Abdul Wahid Abdulrahman Janahi

Adnan A. Wahab Al-Arayyed

Vinit Kohli

Reyadh Yousif Sater



Mahmood Abdul Aziz

Financial Review

This review incorporates the consolidated operating results and the balance sheet of Bank of Bahrain and Kuwait with its overseas branches and its principal subsidiary, CrediMax. The consolidated financial statements have been prepared and presented in conformity with the Bahrain Commercial Companies Law and the Bahrain Monetary Agency Law and in accordance with International Financial Reporting Standards.

Operating results

The Bank has shown a consistently strong operating performance for the year ended 31st December 2004. It has posted a net operating profit of BD 25.678 million, up from BD 23.310 million for 2003. This is a growth in net profits of 10.2% over 2003 profits. This improvement in performance is reflective of strong revenue growth while costs have been contained. The return on average equity has remained consistent at 17.8% in 2004.

Operating income

Total operating income rose to BD 53.1 million, up from BD 47.5 million in 2003, representing a 12% increase. This increase in income is on account of higher net interest income, higher investment trading income, and higher trading income. The higher net interest income in 2004 clearly indicates the Bank's emphasis on the growth in its core business activities. The net income before provisions increased sharply by 17%, from BD 25.6 million in 2003 to BD 29.9 million in 2004.

Net Interest income

The overall net interest income grew from BD 26.1 million to BD 29.5 million, an increase of 13%, reflecting a strong underlying business growth. The loans and investment portfolios grew by 16% and 13% respectively, over the previous year. The net interest margin of 2.29% was only marginally lower than the previous year's margin of 2.31% despite the Bank's conscious decision to improve the credit quality of its portfolio at the cost of higher margins.

Other income

Other operating income includes non interest income which is earned from businesses such as dealing in foreign currencies, investment in funds, the sale of corporate banking and retail banking services and share of profit in associated company. The total income generated from these core activities during the year was 23.6 million, which was 10.3% higher than in the previous year (BD 21.4 million). This growth in income was primarily on account of higher investment trading income, higher FX income, higher other investment income and higher income on managed funds. Fees and commissions earned, which includes income from the Bank's credit card business, loans fees from the Bank's corporate and retail banking customers, was impacted by amortisation of loan fees.

Summary income statement

BD millions	2004	2003	Variance BD millions	Change Percent
Net interest income	29.5	26.1	3.4	13.0%
Other income	23.6	21.4	2.2	10.3%
Total income	53.1	47.5	5.6	11.8%
Operating expenses	(23.2)	(22.0)	1.2	5.5%
Taxation	-	0.1	-0.1	-100.0%
Profits before provisions	29.9	25.6	4.3	16.8%
Net provisions	(4.2)	(2.3)	1.9	82.6%
Net profit (before appropriations)	25.7	23.3	2.4	10.2%

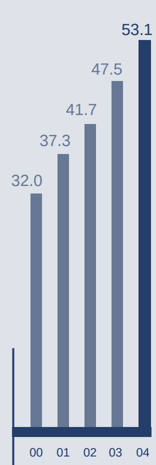
Operating expenses

Total operating expenses, which include staff, premises, equipment, depreciation and other administrative costs, increased by BD 1.2 million (5.5%), reflecting the Bank's continuous investment in technology and human resources. The staff cost was higher by BD 0.7 million, which included the cost of new recruits, salary adjustments, as well as other benefits. Other operating costs and depreciation grew marginally over 2003, by BD 0.47 million. The continuous efforts to curtail revenue expenditure have resulted in a greatly improved cost-to-income ratio of 43.7%, as compared to 46.3% in 2003.

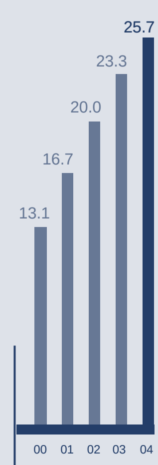
Net provisions

The Bank follows the International Accounting Standard (IAS) 39 with regard to accounting for impairment of financial assets. The provisions for impairment of the Bank's financial assets are arrived at after calculating the Net Present Value of the anticipated future cash flows from financial assets, discounted at original interest rates. This approach to provisioning for impairment of the Bank's financial assets is aimed at providing more realistic estimates of the impairment in the value of the assets, thereby giving greater protection to the Bank's depositors and preserving the capital base of the Bank.

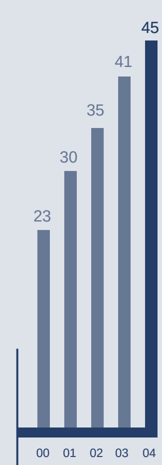
The net provisions for the year were BD 4.2 million, up from BD 2.3 million last year. While the Bank did recover a substantial amount against its non-performing loans, the recoveries were offset by a higher level of provisioning as the Bank continued its strategy to provide aggressively against its non-performing portfolio as a measure of prudence.



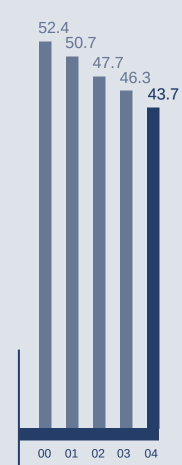
Total income
BD million



Net profit
BD million



Earnings per share
Fils



Cost/income
%

Financial position

The total balance sheet size of the Bank grew over 8.2% year-on-year. Over 11% of the balance sheet was funded by shareholders' equity with the rest coming from customer, medium term deposits and inter-bank deposits. Over 68% of the growth in the Bank's loans and advances portfolio was funded by growth in customer deposits, reflecting the Bank's strength in sourcing stable funding from its customer base.

Assets

The total asset base of the Bank continued to grow, registering an 8.2% growth in total assets. For the second year running, the loans portfolio of the Bank grew in double digits, crossing 16% growth in 2004.

The investments portfolio of the Bank is classified into four categories namely "Held For Trading", "Available For Sale", "Originated Investments" and "Held To Maturity". They consist of quoted bonds, equities and unquoted securities that are mainly acquired with the intention of being retained for long term and current debt and equity securities that are held for trading purposes. At end of 2004, 39.9% of these investments were in the form of quoted bonds and equities (58.5% at the end of 2003).

Those investments classified as "Available For Sale" have been measured at Fair Value and the resultant gains/losses have been taken directly to the Bank's equity. During 2004, the Bank reclassified its held to maturity investments to "Available For Sale" investments, to restructure its balance sheet in view of the rising interest rate scenarios in early 2004. Investments also include long-term Kuwaiti treasury bonds and externally managed portfolios of well-diversified funds.

Investment in associated company represents the Bank's 20.25% interest in the equity of the Bahrain Commercial Facilities Company, a public shareholding company. The carrying value of this investment represents the Bank's share in the total shareholders' equity of the company.

Loans, advances and overdrafts, net of provisions for bad and doubtful debts, increased by BD 106 million to BD 765 million, reflecting an increase of 16% over 2003. This increase came from growth in corporate and consumer lending, mainly in Bahrain and as well as Kuwait. As a percentage of total assets, the Bank's loans & advances increased in 2004 to 53.8% from 50.2% in the previous year.

Summary balance sheet

BD millions	2004	2003	Variance BD millions	Change Percent
Assets				
Cash and balances with central banks	35.7	42.1	-6.4	-15.20%
Treasury bills	25.4	73.0	-47.6	-65.21%
Deposits and due from banks	187.2	168.0	19.2	11.43%
Loans and advances	764.7	659.2	105.5	16.00%
Investments	381.9	341.9	40.0	11.70%
Other assets	25.9	29.4	-3.5	-11.90%
Total assets	1,420.8	1,313.6	107.2	8.16%
Liabilities				
Deposits and due from banks	228.9	287.9	-59.0	-20.49%
Borrowings under repurchase agreements	72.2	3.5	68.7	1962.86%
Term loans	-	37.7	-37.7	-100.00%
Medium term deposits from banks	94.2	47.1	47.1	100.00%
Customer deposits	844.5	772.2	72.3	9.36%
Other liabilities	23.2	23.0	0.2	0.86%
Total liabilities	1,263.0	1,171.3	91.7	7.83%
Shareholders' equity (before appropriations)	157.8	142.3	15.5	10.89%
Total liabilities & shareholders' equity	1,420.8	1,313.6	107.2	8.16%

Treasury bills and inter-bank deposits are money market instruments held essentially for liquidity purposes. Other assets mainly include accrued interest receivable, fixed assets net of accumulated depreciation, acquired assets pending sale, and prepaid expenses.

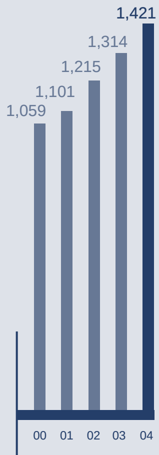
Liabilities

Current, savings and other deposits include balances of interest-bearing and non interest-bearing accounts due to customers on demand and term deposits taken with different maturity dates, in various currencies and at varying rates of interest. Customer deposits increased 9.4% to BD 844.5 million from BD 772.2 million at the end of 2003. Growth in stable customer deposits has been the thrust area for the Bank. Deposits from banks and other financial institutions (including borrowings from repurchase agreements) increased to BD 301.1 million from BD 291.4 million, up marginally by 3.33%.

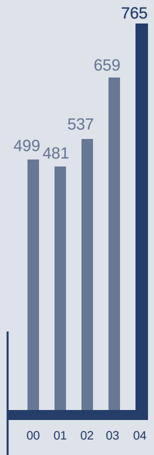
During the year, the Bank repaid the entire term loans of BD 37.7 million outstanding as of last year. This funding was replaced by a successful medium term deposit from banks for a similar tenor with the objective of diversifying sources of funds and continually improving the maturity structure of the Bank’s balance sheet. Interest payable and other liabilities consist of accrued interest payable on interest bearing deposits, accrued expenses and provisions for contingent liabilities.

Capital adequacy

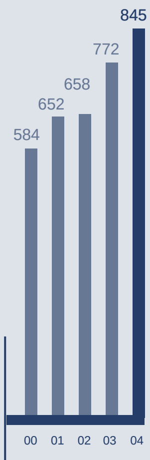
Shareholders' equity, before appropriations, increased to BD 157.8 million at the end of 2004 from BD 142.3 million at the end of 2003. This has strengthened the financial position of the Bank. With this strong capital position, the Bank's capital adequacy ratio at end of 2004 stood at 18.82% which is well above the 8% minimum required by the Basle Accord. This ratio measures total qualifying capital held by a bank in relation to its risk weighted assets and contingents. The Bahrain Monetary Agency had increased this minimum requirement to 12.0% with effect from 1998 for locally registered banks.



Total assets
BD million



Loans and advances
BD million



Cutomer deposits
BD million

Shareholders’ equity
BD million

Risk Management

Efficient and timely management of risks involved in the Bank's activities is critical to its financial soundness and profitability. Risk management involves identifying, measuring, monitoring and managing of risks on a regular basis. The objective of risk management is to increase shareholders' value and achieve return on equity that is commensurate with the risks assumed. To achieve this objective, the Bank uses the best risk management practices and skilled, experienced people.

Credit risk

Credit risk is defined as the potential that the Bank's borrower or counterparty will fail to meet its obligations in accordance with the agreed terms. The goal of credit risk management is to maximize the Bank's risk adjusted rate of return by maintaining credit risk exposures within acceptable parameters.

The Bank has well defined policies and procedures for identifying, measuring, monitoring and controlling credit risk in all of the Bank's activities, at the level of individual credit and portfolio. Credit limits are approved after thorough assessment of the credit worthiness of borrower or counterparty, including the purpose and structure of credit, and its source of repayment. Credit proposals are reviewed by Credit Management Department (CMD) before approval by the appropriate approving authority is obtained. Such reviews are conducted independent of Business Units, by CMD, which reports directly to the General Manager.

The Bank devises specific business and risk strategies relating to Corporate, Retail, Investments and Treasury areas, within the ambit of Group risk policies and procedures. Any additional risks associated with such strategies are discussed in the RMC meetings and necessary risk control measures are applied through amendments to policies, procedures and circulars. The Bank also draws up comprehensive Risk Management Strategy every year and monitors the progress.

The Credit growth, quality and portfolio composition are monitored continuously to maximize risk adjusted return and reduce the level of incidence of impairment and accretion of marginal credits. The Bank monitors concentration risk by setting up limits for maximum exposure to individual borrower or counterparty, country, bank and industry. Such limits are also stipulated for each product. These limits are approved after detailed analysis and are reviewed and monitored regularly.

Day to day monitoring of individual borrower or counterparty exposure is the responsibility of the respective Business Unit. The Bank's Credit Administration Unit, a part of the CMD, ensures that credit facilities are released after proper approval and against proper documentation. It also monitors excesses over limits, past dues, expired credits and promptly escalates exceptions if any, for corrective action.

The Bank has a risk asset rating policy which defines criteria for rating of risk assets. All credits are assigned rating in accordance with the defined criteria. All lending relationships are reviewed at least once in a year and more frequently in the case of non-performing assets (NPAs). The Internal Audit Department conducts independent review of risk assets periodically and submits its report to Senior Management/Audit Committee. The Bank endeavours continuously to improve upon the internal Credit risk rating methodologies and Credit risk management policies and practices, to reflect the true Credit risk and testify Credit culture in the Bank.

It is the Bank's policy to ensure that provisions for credit loss are maintained at an adequate level. For loans and advances considered by the management as individually significant, specific provision is made for the impairment loss worked out on the basis of estimated discounted value of future cash flows in line with IAS-39 guidelines. For the remaining accounts, which are individually not significant, specific provision is made based on historic trends and the current economic environment. All provisions are approved by the Provision Committee, which comprises members of the Executive Management.

In order to give more attention and make concerted efforts for recovery of non-performing loans and advances, they are managed by experienced and skilled staff under separate recovery / loan work out sections within Retail, Corporate and International Banking Divisions.

Liquidity risk

Liquidity risk is defined as potential inability of the Bank to meet its financial obligations (liquidity needs) due to funding mismatch. Management of liquidity risk requires that the Bank can meet its cash financial obligations as and when they fall due.

The Bank has in place Liquidity risk policy which describes the roles and responsibilities of ALMC and Treasury, and stipulates the broad guidelines with regard to minimum liquid assets to be maintained by the Bank. The Bank uses maturity ladder (time buckets) approach for managing its liquidity. The limits for funding requirement for each time bucket of the maturity ladder, the cumulative outflow of cash for each time bucket and various liquidity ratios to be maintained are approved by the ALMC based on Annual Liquidity Strategy. It is the Bank's policy to keep its assets in high quality liquid assets such as inter-bank placements, Treasury Bills and Government Bonds, to ensure that funds are available to meet maturing liabilities, un-drawn facilities and deposit withdrawals. A substantial proportion of the Bank's deposits is made up of retail current, savings and fixed deposit accounts which, though payable on demand or at short notice, have traditionally formed part of a stable deposit base and a source of core fund.

The day to day management of liquidity risk is the responsibility of the Global Treasurer. He monitors the sources and maturities of assets and liabilities closely and ensures that limits stipulated by the ALMC are complied with and that there is no concentration of funding from any one source.

The Bank also draws up Contingency plans to deal with extraordinary conditions of liquidity risk after comprehensive scenario analysis.

Interest rate risk

Interest rate risk is the exposure of the Bank's financial condition to adverse movements of interest rates. The Bank is exposed to this risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or re-price in a given period. Excessive interest rate risk can pose a significant threat to the Bank's earnings and capital base. Accordingly, an effective risk management process that maintains interest rate risk within prudent levels is essential to the safety and soundness of the Bank.

It is the Bank's policy to keep its assets and liabilities mismatches at stable and acceptable levels to maintain steady net interest income. The Bank monitors interest rate risk based on gap / duration limits.

The Bank also uses ‘what if’ scenarios for changes, if any, in interest rates, for projecting net interest income of the Bank. In a scenario of a 100 basis point increase in the interest rates, the static interest rate gaps (as on 31 December 2004) would get repriced and Net Interest Income would increase by BD 0.41 millions. The Bank uses derivative instruments such as interest rate swaps, floating rate agreements and bond futures to manage interest rate risk. Whilst day to day management of interest rate risk is the responsibility of the Global Treasurer, ALMC also reviews the interest rate risk reports periodically.

Market risk

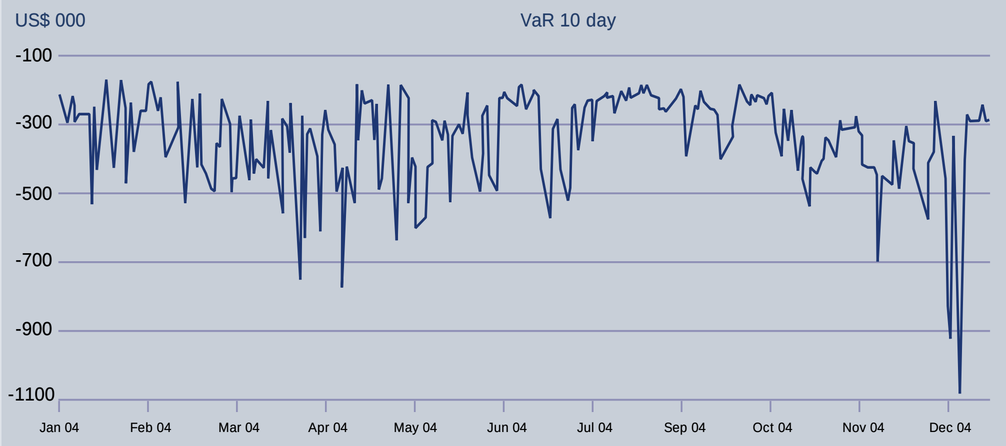
Market risk is defined as the risk of losses in on or off balance sheet positions of the Bank arising from movements in market prices of interest rate related instruments, equities in the trading book and foreign exchange and commodity risk throughout the Bank.

The Bank has clearly defined policies for conducting investment (including trading investments) and foreign exchange business, which stipulate limits for these activities. Investments are made strictly in accordance with investment acceptance criteria which ensure that investments are marketable and liquid. The Bank does not undertake any commodity trading activity.

The Bank uses internal Value-at-Risk (VaR) model for measuring general market risk. The internal model was approved by the Bahrain Monetary Agency. VaR is calculated using a 99% confidence level for a 10 day holding period. This implies 1% possibility of the loss exceeding the VaR amount calculated by the model. As at 31st December 2004, VaR calculated based on the above parameters was BD 118,446 (USD 314,181).

A graph of VaR for the year 2004 is given below. The graph depicts the 10-day horizon VaR movement for each day.

Value at Risk daily movements



Risk Management Department conducts backtesting in accordance with the Market Risk Capital Adequacy Regulations issued by the Bahrain Monetary Agency. Backtesting involves comparing on a daily basis, the one-day daily VaR with the average daily profit and loss (i.e. average of that day and the next day profit and loss). The objective is to ensure that the assumptions used for computing VaR are reasonable and result in a VaR number that is a good indicator of worst possible losses.

The chart below depicts the results of comparing the average profit and loss against the consolidated VaR for Bahrain and Kuwait during the year 2004. In circumstances where the average profit and loss was a loss, the VaR was always greater than the loss, indicating a high correlation between the movement of projected loss and actual loss. During the year actual loss never exceeded the VaR estimates indicating that the assumptions used in computation of the VaR number are reasonable.

The Bank also regularly conducts stress testing to identify events or scenarios that could greatly impact material trading positions taken by the Bank. As per the Bahrain Monetary Agency requirements, validation of the internal model is conducted by the Internal Audit Department of the Bank as well as by the external auditors.

Legal risk

Legal risk is the risk that contracts are not legally enforceable or documented correctly. It is the Bank's policy to use standard documents for the majority of its lending. The standard documents of the Bank are prepared in consultation with the Bank's in-house Legal Department and/or external legal counsel. All non-standard documents are approved by the Bank's in-house Legal Department and/or external legal counsel.

The policies and procedures of the Bank ensure that credit facilities are released after obtaining proper documents.

Operational risk

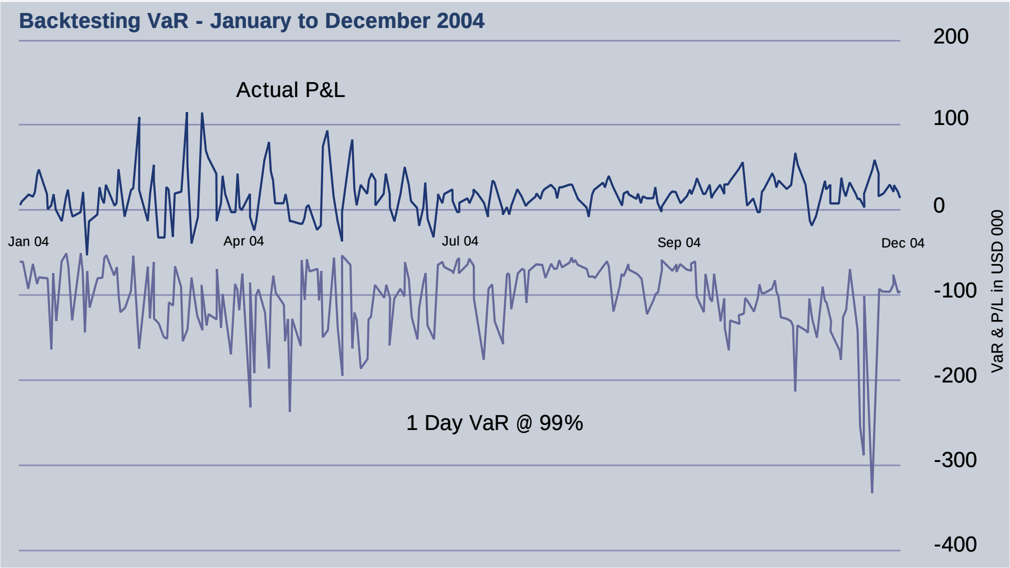
Operational risk is the exposure to loss resulting from inadequate or failed internal processes, people and systems or from external events. The Bank has clearly defined operations procedures for each of its products and services. The Bank has advanced computer systems which enable it to run operations with speed and accuracy.

All computer systems and operations procedures are approved by Internal Audit Department. The Internal Audit Department operates independent of other units of the Bank and reports directly to the Audit Committee which consist members of the Board. It conducts regular reviews of all business areas of the Bank and reports control deficiencies and exceptions to the Bank's policies and procedures.

It also recommends measures to improve operational risk and these recommendations are implemented by the management immediately.

The Bank also has contingency plans to take care of any failure of its computer systems. Regular back-ups are made for all important datasets and they are stored outside the Bank's premises. This ensures that in case of any system failure, the Bank will be in a position to continue its operations without the loss of critical data or business transactions. As part of the disaster recovery plan, the Bank has established a back up site centre to stand in and be operational during an emergency. The Bank established a specific Business Continuity Plan (BCP) unit. The main objective of BCP is to ensure that in the event of full/partial disaster, the Bank should be able to continue providing essential services to customers so that the adverse effect of any disaster on the Bank’s business is minimized.

Operational risk framework comprising Key Risk Areas, Risk Grading, Key Control Standards, Key Risk Indicators, in line with Basel II / BMA requirements, is under implementation.



Additional Disclosures

I. Corporate Governance

BBK's high standard of corporate governance is fundamental to the Bank's leading position in the local and regional banking sector and underpins BBK's standing within the community. The governance of the Bank remains under continuous review, in order to enhance compliance levels according to international standards and best practice. This endeavour, the direct responsibility of the Board of Directors, is in line with the policies of regulatory authorities and the statutory requirements in the Kingdom of Bahrain and other countries where BBK operates.

II. Board of Directors

The Board of Directors comprising 12 members (elected and nominated) functions under the direction of the Chairman to oversee implementation of strategic initiatives of the Bank and its functioning within the agreed framework in accordance with relevant statutory and regulatory structures.

Board Committees

Insiders Committee

A committee of Board of Directors consisting of minimum three members having responsibility for tracking, monitoring and reporting trading activities of insiders in accordance with stipulation of BMA Guidelines on Insiders.

Executive Committee

Under the chairmanship of Mr Rasheed Al-Maraj, the Executive Committee reviews, approves and directs executive management on all matters raised to the Board of Directors.

Audit Committee

The Audit Committee's Terms of Reference are as follows:

1. Membership

The Committee shall be appointed by the Board from amongst the non-executive directors of the Company and shall consist of not less than 3 members. A quorum shall be 2 members. The Chairman of the Committee shall be appointed by the Board.

2. Attendance at meetings

The General Manager Chief Executive Officer, the Head of Internal Audit, and a representative of the External Auditors shall normally attend meetings. However, at least once a year the Committee shall meet with the External Auditors without any Executive Board member present. The Board Secretary shall be the Secretary of the Committee.

3. Frequency of meetings

Meetings shall be held four times a year.

4. Authority

The Committee is authorised by the Board to investigate any activity within its terms of reference. It is authorised to seek any information it requires from any employee and all employees are directed to cooperate with any request made by the Committee. The Committee is authorised by the Board to obtain outside legal or other independent professional advice and to secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

5. Duties

The duties of the Committee shall be:

- *To review the internal audit programme, consider the major findings of internal audit review, investigations and management's response, and ensure coordination between the internal and external auditors.*
- *To keep under review the effectiveness of internal control systems, and in particular review the external auditor's management letter and management's response.*
- *To consider other topics, as defined.*

6. Reporting procedures

The Secretary shall circulate the minutes of meetings of the Committee to all members of the Board of Directors.

Strategy Committee

The Strategy Committee is under the chairmanship of Mr Murad Ali Murad, is responsible for reviewing and recommending strategic initiatives submitted by executive management to the Board of Directors.

Compensation Committee

The Compensation Committee's Terms of Reference are as follows:

1. Mission
The Compensation Committee, herein after referred to as the Committee, is responsible for recommending to the Board of Directors, herein after referred to as the Board, the form and amount of director and executive management compensation, approving the compensation policy and special compensation plans, including annual bonus schemes, share option plans and staff savings schemes across the Bank.

In the context of this document, Executive Management is defined to include, the General Manager Chief Executive Officer (GM CEO), Deputy General Managers, Assistant General Managers (or equivalent), General Manager of subsidiaries and any other position reporting to the GM CEO or the Board.

2. Membership
2.1. Members of the Committee shall be appointed and removed by the Board. The Committee shall elect at the time that the Committee is established or every year after the Annual General Assembly a Chairman and a Deputy who shall chair the meeting in the absence of the Chairman.

2.2. The Committee shall consist of not less than three members.

2.3. Only members of the Committee have the right to attend Committee meetings. However, other individuals such as the General Manager Chief Executive Officer, the Head of Human Resources and external advisers may be invited to attend for all or part of any meeting as and when appropriate.

3. Secretary
3.1. The Board Secretary shall act as the Secretary of the Committee.

4. Quorum
4.1. The quorum necessary for the transaction of business shall be two including the Chairman or the Deputy Chairman. A duly convened meeting of the Committee at which a quorum is present shall be competent to exercise all or any of the authorities, powers and discretions vested in or exercisable by the Committee.

4.2. Any transaction of business of the Committee to be conducted by circulation shall require unanimous approval, allowing three business days for response.

4.3. In case of an equality of votes the Chairman of the Committee meeting shall have a casting vote.

5. Meetings

5.1. The Committee shall meet at least twice a year and at such other times as the Chairman of the Committee shall require.

6. Notice of Meetings
6.1. Meetings of the Committee shall be summoned by the Secretary of the Committee at the request of any of its members.

6.2. Unless otherwise agreed, notice of each meeting confirming the venue, time and date together with an agenda of items to be discussed, shall be forwarded to each member of the Committee, any other person required to attend and all other non-executive directors, no later than five working days before the date of the meeting. Supporting papers shall be sent to Committee members and to other attendees as appropriate, at the same time.

7. Minutes of Meetings
7.1. The Secretary shall minute the proceedings and resolutions of all Committee meetings, including the names of those present and in attendance.

7.2. Minutes of Committee meetings shall be circulated promptly to all members of the Committee and, once agreed, to all members of the Board.

8. Annual General Meeting
8.1. The Chairman of the Committee shall attend the Annual General Meeting prepared to respond to any shareholder questions on the Committee's activities.

9. Duties
The Committee shall:

9.1. Determine and agree with the Board the framework or broad policy for the compensation of the directors and executive management and make recommendations on policies relating to the recruitment, retention and termination for executive management.

9.2. Have responsibility for recommending to the Board the form and amount of the compensation for all directors.

9.3. Determine the policy for the disclosure of directors and executive management's compensation.

9.4. Ensure that contractual terms on termination, and any payments made, are fair to the individual and the Bank, that failure is not rewarded and that the duty to mitigate loss is fully recognized.

9.5. Review and recommend to the Board employee compensation budget, benefits, equity programme and any changes in employee benefit structure throughout the Bank.

9.6. Be exclusively responsible for establishing the selection criteria, selecting, appointing and setting the terms of reference for any remuneration consultants who advise the committee.

9.7. Make available the Committee's terms of reference. These should set out the Committee's delegated responsibilities and be reviewed and, where necessary, updated annually.

9.8. Perform any other duties or responsibilities expressly delegated to the Committee by the Board from time to time.

10. Reporting Responsibilities

10.1. The Committee Chairman shall report formally to the Board on its proceedings after each meeting on all matters within its duties and responsibilities.

10.2. The Committee shall make whatever recommendations to the Board it deems appropriate on any area within its remit where action or improvement is needed.

10.3. The Committee shall produce an annual report of the Bank's compensation policy and practices, which will form part of the Bank's Annual Report and ensure each year that it is put to shareholders. The Annual Report will also state the frequency of, and attendance by members at, compensation committee meetings.

11. Other
11.1. The Committee shall, at least once a year, review its own performance, constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the Board for approval.

11.2. The terms of reference of the Committee shall be available on request and placed on the Bank's website.

12. Authority
12.1. The Committee is authorized by the Board to seek any information it requires from any employee of the Bank in order to perform its duties.

12.2. The Committee, in connection with its duties, is authorized by the Board to obtain advice and assistance, as needed, from internal or external legal counsel, accounting firms, search firms, compensation specialists or other advisors, at the Bank's expense.

III. Executive Management

The Bank's Executive Management under the leadership of the General Manager Chief Executive Officer, report to the Board of Directors.

Executive Management Committees

All management committees are chaired by the General Manager Chief Executive Officer, Dr. Farid Al Mulla. The committees meet on a monthly basis.

Asset and Liability Management Committee

The Asset and Liability Management Committee is responsible for enhancing shareholder value by the establishment of policies and guidelines for the overall management of the balance sheet and its associated risks.

Senior Human Resources Committee

The Senior Human Resources Committee is responsible for the optimisation of human capital in the Bank through the establishment of appropriate policies, procedures and guidelines for the management of human resources.

Provision Committee

The Provision Committee reviews and decides on the Bank's provisioning requirements for loans and advances, and investments.

Risk Management Committee

The Risk Management Committee is responsible for the identification, measurement, monitoring and control of risk; establishment of risk policies and procedures in pursuit of adopting best risk management practices is also part of its scope of work.

Strategy Review Committee

The Strategy Review Committee reviews and monitors progress on strategic initiatives.

IV. Compliance and Anti Money Laundering

Compliance with regulatory and statutory provisions is of paramount importance. The Bank has established a Compliance Unit to act as the focal point for implementing local regulatory and statutory requirements. Anti Money Laundering forms an important area of the compliance function, besides areas of corporate governance, disclosure standards, adherence to best practices and conflicts of interest.

The Bank has sound Know Your Customer policies, procedures for identifying and reporting suspicious transactions, a programme for periodic awareness training to staff, a designated Money Laundering Reporting Officer; and has taken other initiatives in keeping with Anti Money Laundering Regulations of the Bahrain Monetary Agency. The Bank's Anti Money Laundering measures are annually audited by independent auditors. The overseas branches in India and Kuwait and its subsidiary (Credimax) have designated compliance and MLRO functions to ensure implementation of local stipulations and to meet the minimum requirements of Bahrain Monetary Agency.

The Bank is committed to combating Money Laundering and, towards this end, implements all 'Prevention of Money Laundering Regulations' and other guidelines issued by the Bahrain Monetary Agency. These regulations and guidelines are consistent with the FATF recommendations, the Customer Due Diligence for Banks' paper and best international practices.

V. Code of Conduct

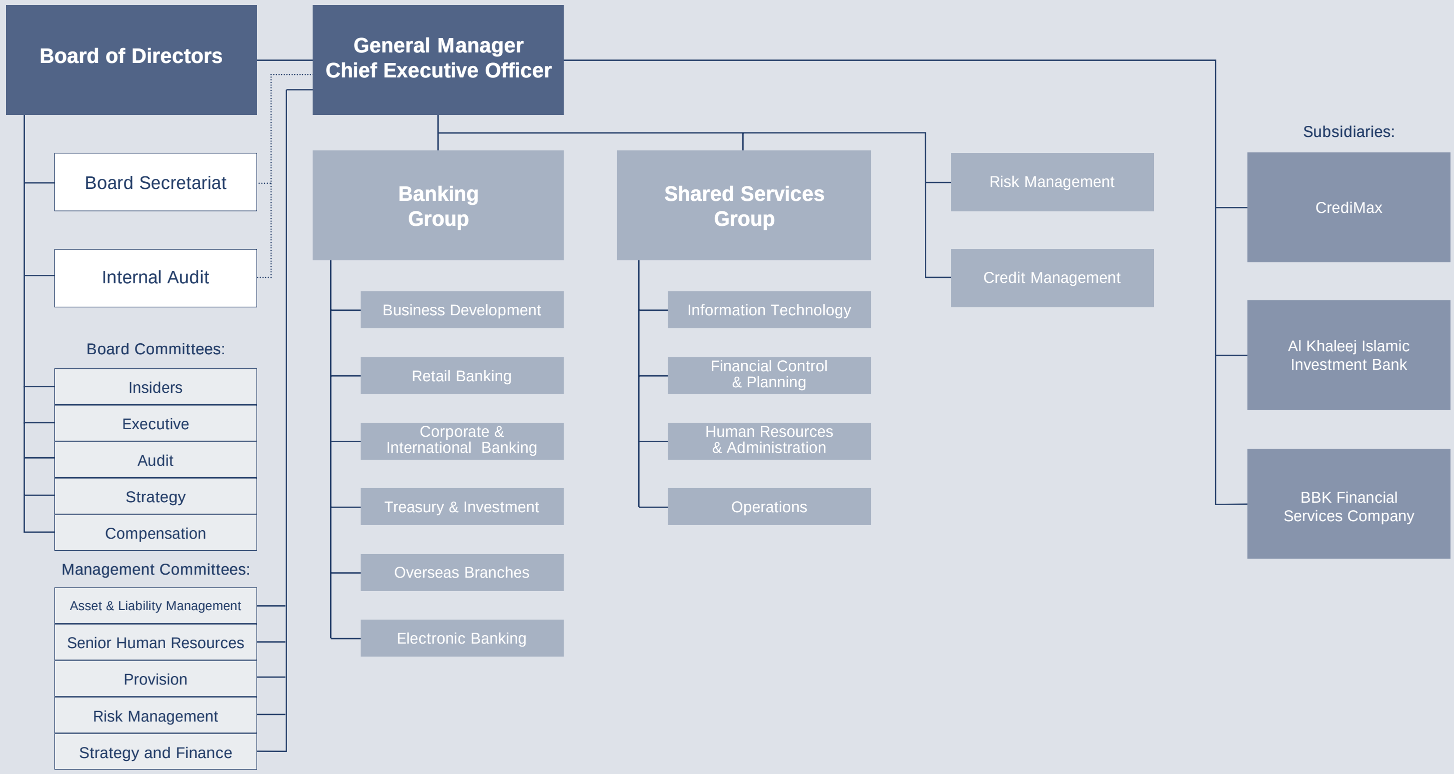
The Bank's Code of Conduct covers the conduct of BBK directors. The code binds signatories to the highest standards of professionalism and due diligence in the performance of their duties. It also covers conflicts of interest, disclosure and the confidentiality of insider information.
Board members are bound by specific regulations relating to insider trading and are required to disclose details of their shareholdings in the Bank.

VI. Communication Strategy

The Bank endeavours to communicate to its stakeholders by means of internet (www.bbkonline.com) and/or local newspapers for all material events which merit announcements.

VII. Incentive Scheme

As part of the Bank's incentive and compensation policy the group has an Employee Shares Option Scheme, under which certain categories of employees are notionally allotted specified number of share, at a grant price, with a defined resting period. On completion of the resting period the employee can exercise his option.



VIII. Organisational Structure

During 2004, the organisational structure was amended by dividing the Treasury, Investment & Overseas Branches division into two divisions, namely Treasury & Investment, and Overseas Branches, as illustrated in the diagram above.

IX. Directors' Profiles

Murad Ali Murad

Chairman

Chairman of the Strategy Committee, the Audit Committee and the Compensation Committee

Board Director- Bahrain Telecommunications Company (Batelco); Board Director- Bahrain Commercial Facilities Co. (B.S.C.); Board Director - Bahraini Kuwaiti Insurance Co. (B.S.C.); Deputy Chairman of Housing Bank; Member - Council of Vocational Training in Banking Sector; Deputy Chairman - Board of Trustees of Ibn Khuldoon National School; Chairman Board of Trustees of Human Resources Development Fund Banking & Financial Sector

Jassem Hasan Ali Zainal

Deputy Chairman

Member of the Executive Committee, the Strategy Committee and the Compensation Committee

Corporate Secretary and General Manager, Investment – Gulf Bank, Kuwait; Member of International Fund Managers Ltd.

Rasheed Mohammed Al-Maraj

Board Director

Chairman of the Executive Committee and member of the Strategy Committee

Chief Executive Officer – Arab Petroleum Investment Corporation, Kingdom of Saudi Arabia; Chairman – Bahrain Telecommunications Company (Batelco); Member – Economic Development Board.

Yacuob Yousef Al Fulaij

Board Director

Deputy Chairman of the Executive Committee

Director – National Bank of Kuwait.

Mohammed Salahuddin

Board Director

Chairman – Mohammed Salahuddin Consulting Engineering Bureau; Board Member – Bahrain Water Bottling and Beverages Company (Closed) B.S.C.; Board Member – Sunni Waqf Directorate; Board Member – Bahrain Businessmen's Association.

Hamad Ahmad Al Busairi

Board Director

Member of the Executive Committee and the Compensation Committee

Senior Investment Manager – Kuwait Investment Authority, Kuwait; Board Director – Kuwait Investment Company.

Abdulla Mohammed Al Sumait

Board Director

Member of the Audit Committee

Deputy Chief General Managers – Al-Ahli Bank of Kuwait; Chairman – Union of Kuwaiti Banks; Director – Credit Information Network Company (K.S.C.C.).

Shaikh Mohammed bin Isa Al Khalifa

Board Director

Member of the Executive Committee

Director – Finance and Investment (GOSI),Chairman – Securities and Investment Company; Director – Bahrain Commercial Facilities Company; Director – National Motor Company; Director – Bahrain Stock Exchange; Director – Bahrain Telecommunication Co.; Director – Bahrain

International Golf Course Company.

Aref Saleh Khamis
Board Director
Member of the Executive Committee and the Compensation Committee
Assistant Under-Secretary for Financial Affairs – Ministry of Finance and National Economy; Director – Gulf Aluminium Rolling Mills Company; Director – Arab Ship Building & Repair Yard; Director – Shaikh Mohammed bin Khalifa bin Salman Al Khalifa Cardiac Centre; Director – Bahrain Petroleum Company (Bapco); Member – Tender Board; Member – Supreme Council of Traffic. Member – Zakat Fund.

Saeed A. Karim Al-Marzooq
Board Director
Member of the Audit Committee
Assistant Director General for Finance and Administrative Affairs – Pension Fund Commission; Board Member – Solidarity Co.

Abdul Majeed Haji Al Shatti
Board Director
Member of the Audit Committee
Chairman & Managing Director of Commercial Bank of Kuwait
Board Member – Housing Finance Co.

The Company Secretary: Saad Mohd Al Hooti

X. Directors' Remuneration

The Director's remuneration, allowances and expenses for attendance at Board meetings for 2004 amounted to BD 386,030 (2003: BD 422,621).

XI. Executive Management Profiles

Dr Farid Ahmed Al Mulla
General Manager Chief Executive Officer
PhD in Economics and International Relations from University of Sussex, UK – 1982. 22 years of banking experience. Joined Bank of Bahrain and Kuwait in 1990.

Ahmed Al Banna
Deputy General Manager, Banking Group
BSc from University of Houston, USA – 1978. 21 years of banking experience. Joined Bank of Bahrain and Kuwait in 1987.

Dr Khalid Abdulla
Assistant General Manager, Business Development
PhD in Economics from Exeter University, UK – 1991. 20 years academic and research experience with University of Bahrain.
Joined Bank of Bahrain and Kuwait in 2000.

Jamal Mohammed Hijres
Assistant General Manager, Retail Banking
MBA, University of Bahrain – 1991. 26 years of banking experience, all with Bank of Bahrain and Kuwait.

Abdul Hussain Bustani
Assistant General Manager, Human Resources and Administration
Higher National Diploma in Civil Engineering from Trent University, Nottingham, UK – 1978. 17 years of banking experience. Joined Bank of Bahrain and Kuwait in 1988.

Abdulla Abdulrahman Hussain
Assistant General Manager, Information Technology
MBA from University of Bahrain – 1994. 17 years of experience in information technology. Joined Bank of Bahrain and Kuwait in 2002.

Abdul Karim Ahmed Bucheery
Assistant General Manager, Corporate and International Banking
Bachelor of Economic Sciences from the University of Aleppo, Syria – 1976. 27 years of banking experience. Joined Bank of Bahrain and Kuwait in 2001.

Abdul Rasool Turki
Assistant General Manager, Treasury and Investment
Diploma in science from People's College, Nottingham, England – 1977. 26 years of Banking experience. Joined Bank of Bahrain and Kuwait in 2004.

Abdul Wahid Abdulrahman Janahi
Assistant General Manager, Electronic Banking
Banking Group MBA from University of Bahrain – 1997. 9 years of experience in telecommunications. Joined Bank of Bahrain and Kuwait in 2001.

Reyadh Yousif Sater
Senior Manager, Internal Audit
MBA, University of Glamorgan – UK, 2001. 27 years of banking experience. Joined Bank of Bahrain & Kuwait in 1978.

Amit Kumar
Senior Manager, Risk Management
MBA, Indian Institute of Management, Ahmedabad, India – 1983. 21 years of banking experience. Joined Bank of Bahrain and Kuwait in 1994.

Adnan A. Wahab Al-Arayyed
Senior Manager, Credit Management
Bachelor of Commerce in Business Administration, Beirut Arab University – 1984. 23 years of banking experience, all with Bank of Bahrain and Kuwait.

Vinit Kohli
Chief Financial Officer, Financial Control and Planning
BCom (Honours) Delhi University, CA, Institute of Chartered Accountants of India. 23 years of experience. Joined Bank of Bahrain and Kuwait in 2002.

Mahmood Abdul Aziz
Senior Manager, Operations
Executive Management Diploma from University of Bahrain, Gulf Executive Management Program, University of Virginia. 33 years of banking experience. Joined Bank of Bahrain and Kuwait in 1976.

XII. Disclosure Standards Requirements

A. Names and nationalities of major shareholders:

Shareholder	Nationality	No. of shares	%
Bahrain Citizen	Bahraini	111,883,464	19.66%
The Pension Fund Commission	Bahraini	107,473,395	18,89%
General Organization for social Insurance	Bahraini	76,374,378	13,42%
Bank of Kuwait & the Middle East	Kuwaiti	38,411,711	6,75%
Gulf Bank	Kuwaiti	38,411,711	6,75%
Commercial Bank of Kuwait	Kuwaiti	38,411,711	6,75%
Al-Ahli Bank of Kuwait	Kuwaiti	38,411,711	6,75%
Kuwait Investment Projects Co.	Kuwaiti	29,255,000	5,14%
Government of Kuwait – Kuwait Investment Authority	Kuwaiti	21,339,836	3,75%
Kuwait Investment Company	Kuwaiti	21,339,836	3,75%
The National Bank of Kuwait	Kuwaiti	19,342,968	3,40%
Gulf Investment Corporation	Kuwaiti	17,025,543	2,99%
Kuwait International Investment Co.	Kuwaiti	11,381,236	2,00%

Directors' interests

The number of shares held by the directors and their related parties as at:

Director	31.12.2004	31.12.2003
Murad Ali Murad	204,655	204,655
Rasheed Mohammed Al-Maraj	100,000	100,000
Mohammed Salahuddin	238,000	238,000
Saeed A.Karim Al-Marzooq	472	472
Total	543,127	543,127
Related Parties		
Al-Janabeya Co. W.L.L.	15.000	

B. Distribution schedule of each class of equity:

Categories	No. of shares	No. of Shareholders	% of outstanding shares
Less than 1%	127,188,166	2337	22.35
1% to less than 5%	113,385,964	13	19.93
5% to less than 10%	146,291,576	5	25.71
10% to less than 20%	182,196,844	2	32.01
20% to less than 50%	–	–	–
50% and above	–	–	–

XIII. Other Shareholdings

Bahrain Telecommunications Company BSC	2.356%
Securities and Investment Company (Closed)	8.000%
Bahrain Kuwait Insurance Company	6.521%

XIV. Offices and International Branches

Head Office
43 Government Avenue, PO Box 597, Manama, Kingdom of Bahrain.
Tel: (973) 17223 388, Fax: (973) 17229 822
Cable: BAHKUBANK. Telex: 8919 BN. SWIFT: BBKUBHBM

Kuwait Branch
Ahmed Al-Jaber Street, PO Box 24396, 13104 Safat, Kuwait.
Tel: (965) 241 7140, Fax: (965) 244 0937

Mumbai Branch
PO Box 11692, Jolly Maker Chambers II, 225 Nariman Point,
Mumbai 400021, India.
Tel: (9122) 282 3698, Fax: (9122) 204 4458 / 284 1416

Hyderabad Branch
6-3-550 L B Bhavan, Somajiguda, Hyderabad 500482.
Tel: (9140) 339 8219, Fax: (9140) 337 5977

Dubai Representative Office
Creek Tower, Office No. 18A, PO Box 31115, Dubai, UAE.
Tel: (9714) 221 0560 / 221 0570 / 223 7156, Fax: (9714) 221 0260

Shares Registrar Office
KPMG, Hedaya House 2 – 5th floor. PO Box 710,
Manama, Kingdom of Bahrain.
Tel: (973) 1721 5080

Auditors’ Report to the Shareholders

of Bank of Bahrain and Kuwait B.S.C.

We have audited the accompanying consolidated balance sheet of Bank of Bahrain and Kuwait B.S.C. (the Bank) and its subsidiaries (the Group) as of 31 December 2004, and the related consolidated statements of income, cash flows and changes in equity for the year then ended. These consolidated financial statements are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.
We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2004, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements and the contents of the Chairman’s statement relating to these consolidated 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 Bahrain Monetary Agency Law, nor of the memorandum and articles of association of the Bank, have occurred during the year ended 31 December 2004 that might have had a material adverse effect on the business of the Bank or on its consolidated 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.

Ernst & Young

6 February 2005
Manama, Kingdom of Bahrain

Consolidated Financial Statements

Consolidated Balance Sheet

31 December 2004

	Notes	2004 BD '000	2003 BD '000
ASSETS			
Cash and balances with central banks	4	**35,682**	42,146
Treasury bills	5	**25,435**	72,967
Trading investments		**2**	4,454
Deposits and due from banks and other financial institutions		**187,153**	168,052
Loans and advances to customers	6	**764,689**	659,167
Non-trading investment securities	7	**376,131**	332,390
Investment in associated company	8	**5,812**	5,081
Interest receivable and other assets	9	**11,291**	13,988
Premises and equipment		**14,580**	15,373
Total assets		**1,420,775**	1,313,618
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits and due to banks and other financial institutions		**228,852**	287,860
Borrowings under repurchase agreements	10	**72,176**	3,477
Term loans	11	**-**	37,700
Medium term deposits from banks	12	**94,250**	47,125
Customers' current, savings and other deposits		**844,502**	772,175
Interest payable and other liabilities	13	**23,217**	23,029
Total liabilities		**1,262,997**	1,171,366
Shareholders' equity			
Share capital	14	**56,906**	56,906
Treasury stock	14	**(1,053)**	(1,053)
Statutory reserve	15	**23,574**	21,006
General reserve	15	**20,000**	20,000
Cumulative changes in fair values	16	**13,446**	3,986
Foreign currency translation adjustments		**(508)**	(832)
Retained earnings		**24,789**	24,438
Proposed appropriations	17	**20,624**	17,801
Total shareholders' equity		**157,778**	142,252
Total liabilities and shareholders' equity		**1,420,775**	1,313,618

The consolidated financial statements were authorised for issue in accordance with a resolution of the directors on 6 February 2005.

Murad Ali Murad	Jassem Hasan Ali Zainal	Dr Farid Ahmed Al Mulla
Chairman	Deputy Chairman	General Manager Chief Executive Officer

The attached notes 1 to 40 form part of these consolidated financial statements.

Consolidated Income Statement

Year ended 31 December 2004

	Notes	2004 BD '000	2003 BD '000
Interest income	18	50,784	46,437
Interest expense	19	21,259	20,360
Net interest income		29,525	26,077
Other operating income	20	22,411	20,350
Net interest and other operating income		51,936	46,427
Net provision for impairment on loans and advances to customers	6	(2,444)	(1,104)
Net provision for impairment of non-trading investment securities	7	(1,821)	(1,164)
Net operating income after provisions		47,671	44,159
Operating expenses			
Staff costs		13,329	12,592
Other operating expenses		7,753	6,974
Depreciation		2,162	2,470
Total operating expenses		23,244	22,036
Profit from operations		24,427	22,123
Share of profit in associated company		1,251	1,134
Profit before taxation		25,678	23,257
Taxation - foreign units		-	53
Net profit for the year		25,678	23,310
Basic earnings per share (BD)	21	0.045	0.041
Dividend per share (BD)	17	0.035	0.030

The attached notes 1 to 40 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

Year ended 31 December 2004

	2004 BD '000	2003 BD '000
OPERATING ACTIVITIES		
Profit before taxation	25,678	23,257
Adjustments for:		
Net provisions (write backs) relating to:		
Loans and advances to customers	2,444	1,104
Non-trading investment securities	1,821	1,164
Share of profit in associated company	(1,251)	(1,134)
Depreciation	2,162	2,470
Realised (gains) on sale of investments	(6,013)	(2,633)
Taxation - foreign units	-	53
(Increase) decrease in operating assets:		
Mandatory reserve deposits with central banks	(261)	(2,095)
Treasury bills maturing after 91 days	34,002	(21,924)
Trading investments	4,452	(4,014)
Deposits and due from banks and other financial institutions	10,167	(48,797)
Loans and advances to customers	(107,966)	(123,391)
Interest receivable and other assets	2,637	1,581
Increase in operating liabilities:		
Deposits and due to banks and other financial institutions	(59,008)	(38,276)
Borrowings under repurchase agreements	68,699	3,477
Customers' current, savings and other deposits	72,327	113,775
Interest payable and other liabilities	188	8,820
Net cash from (used in) operating activities	50,078	(86,563)
Investing activities		
Purchase of non-trading investment securities	(493,245)	(327,460)
Disposal and maturities of non-trading investment securities	460,894	310,484
Dividends received from associated company	709	608
Purchase of premises and equipment	(1,371)	(1,757)
Net cash (used in) investing activities	(33,013)	(18,125)
Financing activities		
Medium term deposits from banks	47,125	47,125
Term loans repaid	(37,700)	(47,125)
Payment of dividend, directors' remuneration and donations	(17,801)	(15,981)
Net cash (used in) financing activities	(8,376)	(15,981)
Foreign currency translation adjustments	324	864
Increase (decrease) in cash and cash equivalents	9,013	(119,805)
Cash and cash equivalents at beginning of the year	166,200	286,005
Cash and cash equivalents at end of the year (Note 23)	175,213	166,200

The attached notes 1 to 40 form part of these consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

Year ended 31 December 2004

	Notes	Share capital BD '000	Treasury stock BD '000	Statutory reserve BD '000	General reserve BD '000	Cumulative changes in fair values BD '000	Foreign currency translation adjustments BD '000	Retained earnings BD '000	Proposed appropriations BD '000	Total BD '000
Balance at 31 December 2002		56,906	(1,053)	18,675	20,000	(586)	(1,696)	22,852	15,981	131,079
Approval of dividend, directors' remuneration and donations		-	-	-	-	-	-	-	(15,981)	(15,981)
Net profit for the year – 2003		-	-	-	-	-	-	23,310	-	23,310
Portion of realised gain on non trading investments (previously included in retained earnings on adoption of IAS 39)		-	-	-	-	-	-	(1,592)	-	(1,592)
Foreign exchange translation adjustments		-	-	-	-	-	864	-	-	864
Net movement in cumulative changes in fair values	16	-	-	-	-	4,572	-	-	-	4,572
Transfer to statutory reserve		-	-	2,331	-	-	-	(2,331)	-	-
Proposed dividend	17	-	-	-	-	-	-	(16,941)	16,941	-
Proposed directors' remuneration	17	-	-	-	-	-	-	(260)	260	-
Proposed donations	17	-	-	-	-	-	-	(600)	600	-
Balance at 31 December 2003		56,906	(1,053)	21,006	20,000	3,986	(832)	24,438	17,801	142,252
Approval of dividend, directors' remuneration and donations		-	-	-	-	-	-	-	(17,801)	(17,801)
Net profit for the year – 2004		-	-	-	-	-	-	25,678	-	25,678
Portion of realised gain on non trading investments (previously included in retained earnings on adoption of IAS 39)		-	-	-	-	-	-	(2,135)	-	(2,135)
Foreign exchange translation adjustments		-	-	-	-	-	324	-	-	324
Net movement in cumulative changes in fair values	16	-	-	-	-	9,460	-	-	-	9,460
Transfer to statutory reserve		-	-	2,568	-	-	-	(2,568)	-	-
Proposed dividend	17	-	-	-	-	-	-	(19,764)	19,764	-
Proposed directors' remuneration	17	-	-	-	-	-	-	(260)	260	-
Proposed donations	17	-	-	-	-	-	-	(600)	600	-
Balance at 31 December 2004		56,906	(1,053)	23,574	20,000	13,446	(508)	24,789	20,624	157,778
Month end average equity – 2004										144,644
Month end average equity – 2003										131,206

Retained earnings include BD 9,305 thousand (2003: BD 6,156 thousand) of non-distributable reserves.

The movement in foreign exchange translation adjustment represents the net foreign exchange translation gain arising from translating the financial statements of the Group's foreign entities into Bahraini dinars.

The attached notes 1 to 40 form part of these consolidated financial statements.

1 Activities

Bank of Bahrain and Kuwait B.S.C. (the Bank), a public shareholding company, was incorporated in the Kingdom of Bahrain by an Amiri Decree in March 1971 and registered with the Ministry of Industry and Commerce under Commercial Registration (CR) number 1234 dated 16 March 1971. The Bank operates in Bahrain under a commercial banking license issued by the Bahrain Monetary Agency and is engaged in commercial banking activities. The overseas units operate under the laws of their respective countries. The Bank's registered office is at 43 Government Avenue, P O Box 597, Manama, Kingdom of Bahrain. The total number of employees of the Group as of 31 December 2004 is 702 (31 December 2003: 712).

2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries (the 'Group'), all of which have 31 December as the year end. The following is the principal subsidiary:

Name	Ownership	Country of incorporation	Activity
CrediMax B.S.C. (c)	100%	Bahrain	Credit card operations

All material intra-group balances and transactions, including material unrealised gains and losses on transactions, between Group companies have been eliminated on consolidation.

3 Significant accounting policies

The significant accounting policies adopted in the preparation of consolidated financial statements are set out below:

Basis of preparation

The consolidated financial statements have been prepared in conformity with the Bahrain Commercial Companies Law and the Bahrain Monetary Agency Law and is in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB.

The accounting policies are consistent with those used in the previous year.

The consolidated financial statements are prepared in Bahraini Dinar which is the functional currency of the Bank.

Accounting convention

The consolidated financial statements are prepared under the historical cost convention as modified by the remeasurement at fair value of derivatives and trading and available-for-sale investment securities.

Trading investments

Trading investments are held for a short-term period and are initially recognised at cost and subsequently measured at fair value with any gain or loss arising from a change in fair value being included in the consolidated income statement in the period in which it arises. Interest earned or dividends received are included in interest and dividend income respectively.

Deposits and due from banks and other financial institutions

Deposits and due from banks and other financial institutions are stated at cost, adjusted for effective hedges, net of any amounts written off and provision for impairment.

Loans and advances to customers

Loans and advances to customers are stated at amortised cost, adjusted for effective hedges, net of interest suspended, provision for impairment and any amounts written off.

3 Significant accounting policies (continued)

Non-trading investment securities

These are classified as follows:

- Held-to-maturity
- Available-for-sale
- Originated by the Group

All non-trading investments are initially recognised at cost, being the fair value of the consideration given, including incremental transaction costs. These include bonds, equities, managed funds and other investments. Investments in managed funds comprise investments in mutual funds, private equity and credit structured products.

Premiums and discounts on non-trading investments are amortised, using the effective interest rate method, and taken to interest income.

Held-to-maturity

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

Available-for-sale

After initial recognition, investments which are classified as “available-for-sale” are remeasured at fair value, unless fair value cannot be reliably measured. Unrealised gains and losses on remeasurement to fair value, unless part of an effective hedging relationship, are reported as a separate component of equity until the investment is derecognised or the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity along with any transition adjustment to retained earnings arising from the adoption of IAS 39, is included in the consolidated income statement for the period. Any gain or loss arising from a change in fair value of available-for-sale investments, which is part of an effective hedging relationship, is recognised directly in the consolidated income statement to the extent of the changes in fair value being hedged.

Originated by the Group

Investments in debt securities which are funded directly to the issuer are stated at amortised cost, adjusted for effective hedges, less provision for impairment. An adjustment is made to such investments, where effective fair value hedges have been made, to adjust the value of the investment for the fair value being hedged, with the resultant gains or losses being recognised in the consolidated income statement.

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 consolidated income statement.

Impairment is determined as follows:

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

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

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

The provision for impairment of loans and advances also covers losses where there is objective evidence that losses may be present in components of the loans and advances portfolio at the balance sheet date. These are estimated based on historical patterns of losses, the credit ratings allotted to the borrowers and reflect the current economic climate in which the borrowers operate.

3 Significant accounting policies (continued)

Fair values

For investments and derivatives traded in an active market, fair value is determined by reference to quoted market bid prices for assets and quoted market offer prices for liabilities at the close of business on the balance sheet date.

The fair value of investments in mutual funds, managed funds, unit trusts or similar investment vehicles, where available, are based on last published bid price.

For investments where there is no quoted market price a reasonable estimate of the fair value is determined by reference to the current market value of another similar instrument, or is based on the net present value of future cash flows.

The fair value of forward exchange contracts is calculated by reference to forward exchange rates with similar maturities.

The fair value of unquoted derivatives is based on either internal pricing models, discounted cash flows or by reference to brokers' quotes.

Use of estimates

In preparation of the consolidated financial statements, the management makes estimates and assumptions regarding valuations and provisions, thereby affecting the reported amount of financial assets and liabilities and disclosure of contingent liabilities. These estimates and assumptions also affect the revenues and expenses and the resultant provisions, as well as fair value changes reported in equity. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows while determining the level of provisions required for non-performing credit facilities, as well as for impairment provisions for unquoted investments. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty.

Investment in associated company

An associate is a company in which the Group has a long term investment comprising an interest of 20% - 50% in the voting capital or over which it exerts significant influence, and is accounted for using the equity method of accounting.

Premises and equipment

All items of premises and equipment are initially recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment, other than freehold land which is deemed to have an indefinite life.

Collateral pending sale

The Group occasionally acquires real estate in settlement of certain loans and advances to customers. Such real estate is stated at the lower of the net realisable value of the related facility and the current fair value of the collateral acquired assessed on an individual basis. If the current fair value for any individual asset is lower, a provision is created. Gains or losses on disposal, and unrealised losses on revaluation, are recognised in the consolidated income statement.

Deposits

All money market and customer deposits are carried at amortised cost, adjusted for effective hedges, less amounts repaid.

Repurchase and resale agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date (repos) are not derecognised in the balance sheet and are measured in accordance with accounting policies for non-trading investment securities. The liability for amounts received under these agreements is shown as borrowings. The difference between sale and repurchase price is treated as interest expense using the effective interest method.

Assets purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognised in the balance sheet, as the Group does not obtain control over the assets. Amounts paid under these agreements are included in deposits with banks and other financial institutions or loans and advances to customers, as appropriate. The difference between purchase and resale price is treated as interest income using the effective interest rate method.

3 Significant accounting policies (continued)

Taxation

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on foreign operations is provided in accordance with the fiscal regulations of the respective countries in which the Group operates.

With respect to foreign units deferred income taxation is provided using the liability method on all temporary differences at the balance sheet date. Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on laws that have been enacted at the balance sheet date.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Employees' end of service benefits

Costs relating to employees' end of service benefits are accrued in accordance with actuarial and other valuations as required by regulations applicable in each location.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) and the costs to settle the obligation are both probable and able to be reliably measured.

Treasury stock

Treasury stock is stated at cost.

Derivatives

The Group enters into derivative instruments including futures, forwards, swaps, and options in the foreign exchange and capital markets. Derivatives are stated at fair value. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the consolidated balance sheet.

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

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

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

For hedges which do not qualify for hedge accounting, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated income statement for the period. Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. For effective fair value hedges of financial instruments with fixed maturities any adjustment arising from hedge accounting is amortised over the remaining term to maturity. For effective cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated income statement.

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

3 Significant accounting policies (continued)

Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and are, accordingly, not included in the balance sheet.

Offsetting

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

Revenue recognition

Interest income and loan commitment fees, which are considered an integral part of the effective yield of a financial asset, are recognised using the effective yield method unless collectibility is in doubt. The recognition of interest income is suspended when loans become impaired, such as when overdue by more than 90 days. Notional interest is recognised on impaired loans and other financial assets based on the rate used to discount future cash flows to their net present value.

Other fees receivable are recognised when earned. Dividend income is recognised when the right to receive payment is established.

Foreign currencies

Translation of foreign currency transactions

Monetary assets and liabilities in foreign currencies are translated into the functional currency of each entity at rates of exchange prevailing at the balance sheet date. Any gains or losses are taken to the consolidated income statement.

Translation of financial statements of foreign entities

The operations of overseas units are not deemed an integral part of the head office’s operations as each is financially and operationally independent of the head office. The assets and liabilities of foreign entities are translated at rates of exchange ruling at the balance sheet date. Income and expense items are translated at average exchange rates for the period. Any exchange differences are taken directly to "foreign currency translation adjustments" which forms part of equity.

Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with central banks (excluding mandatory reserve deposits), treasury bills and deposits and due from banks and other financial institutions maturing within ninety-one days from the date of acquisition.

Trade date accounting

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

4 Cash and balances with central banks

	2004 BD '000	2003 BD '000
Cash	6,851	7,038
Current account and placements with central banks	9,566	16,104
Mandatory reserve deposits with central banks	19,265	19,004
	35,682	42,146

5 Treasury bills

These are short term treasury bills issued by the Governments of the Kingdom of Bahrain, the State of Kuwait and the Republic of India and are carried at amortised cost.

6 Loans and advances to customers

	2004 BD '000	2003 BD '000
Commercial loans	544,264	478,041
Consumer loans	111,954	100,494
Overdrafts	118,485	112,530
Credit cards	25,937	24,172
Other	22,674	22,822
	823,314	738,059
Less: Provision for impairment and interest in suspense	(58,625)	(78,892)
	764,689	659,167

a) The composition of the loans and advances to customers is as follows:

(i) Industry sector

	2004 BD '000	2003 BD '000
Trading and manufacturing	278,871	221,032
Banks and other financial institutions	105,133	86,794
Construction and real estate	84,307	97,450
Government and public sector	79,373	65,773
Individuals	200,643	188,813
Others	74,987	78,197
	823,314	738,059
Less: Provision for impairment and interest in suspense	(58,625)	(78,892)
	764,689	659,167

(ii) Geographical region

	2004 BD '000	2003 BD '000
Gulf Co-operation Council countries	740,211	652,333
European Union countries	20,327	11,711
Asia	60,225	67,902
Others	2,551	6,113
	823,314	738,059
Less: Provision for impairment and interest in suspense	(58,625)	(78,892)
	764,689	659,167

b) Age analysis of non-performing loans on which interest is not being accrued are as follows:

	2004				2003
	3 months to 1 year BD '000	1 - 3 years BD '000	Over 3 years BD '000	Total BD '000	Total BD '000
Gross non-performing loans	11,103	12,988	55,201	79,292	100,607
Less: Provisions				(39,960)	(42,456)
Less: Interest in suspense				(16,292)	(32,745)
Net outstanding				23,040	25,406

6 Loans and advances to customers (continued)

c) Movements in provisions for loan losses including interest in suspense are as follows:

	2004 BD '000	2003 BD '000
At 1 January	78,892	86,533
Charge for the year	7,306	8,040
Recoveries/write-backs	(4,862)	(6,936)
Interest suspended during the year, net	3,071	3,443
Amounts written off during the year, net	(24,956)	(11,662)
Interest recognised on impaired loans	(599)	(658)
Other movements	(227)	132
Balance at 31 December	58,625	78,892

Other movements include foreign exchange adjustments relating to loans and advances to customers denominated in foreign currencies.

d) As of 31 December 2004, gross loans and advances to customers which were classified as impaired amounted to BD 79.292 million (2003: BD 100.607 million). The total of provisions carried and the value of securities held for these loans amounted to BD 92.028 million (2003: BD 99.639 million).

e) As of 31 December 2004, the balance of restructured loans amounted to BD 16.754 million (2003: BD 5.501 million). The majority of restructuring relates to extending the period of repayments. The restructured loans have no material impact on the current year's earnings and are not expected to have a material adverse effect on future earnings.

7 Non-trading investment securities

	Available-for-sale BD '000	Held-to-maturity BD '000	Originated by the Group BD '000	Total 2004 BD '000	Total 2003 BD '000
Quoted investments					
Quoted equities	26,086	-	-	26,086	21,495
Quoted bonds	85,512	-	38,308	123,820	172,802
Managed funds	2,076	-	-	2,076	991
	113,674	-	38,308	151,982	195,288
Unquoted investments					
Government bonds	16,552	-	100,105	116,657	52,134
Other bonds	4,977	-	35,008	39,985	35,161
Unquoted equities	6,702	-	-	6,702	5,793
Managed funds	55,714	-	-	55,714	42,605
Others	2,396	-	7,100	9,496	4,002
	86,341	-	142,213	228,554	139,695
	200,015	-	180,521	380,536	334,983
Provision for impairment	(3,419)	-	(986)	(4,405)	(2,593)
Balance at 31 December 2004	196,596	-	179,535	376,131	
Balance at 31 December 2003	180,276	45,312	106,802		332,390

During the year, the Group reclassified its 'Held to Maturity' investments to 'Available For Sale' investments. The resulting increase in value of these investments, on reclassification,of BD 2.230 million was taken to the cumulative changes in fair value in equity.

7 Non-trading investment securities (continued)

The movements in provision for impairment on non-trading investment securities are as follows:

	Available-for-sale BD '000	Held-to-maturity BD '000	Originated by the Group BD '000	Total 2004 BD '000	Total 2003 BD '000
Balance at 1 January	1,420	155	1,018	2,593	1,420
Charge for the year	1,853	-	467	2,320	1,164
Write back	-	-	(499)	(499)	-
Other movements	146	(155)	-	(9)	9
Balance at 31 December	3,419	-	986	4,405	2,593

Included under available-for-sale investments are unquoted investments amounting to BD 33.794 million (2003: BD 12.092 million) which are carried at cost. This is due to the unpredictable nature of their future cash flows and the lack of suitable alternate methods for arriving at a reliable fair value.

8 Investment in associated company

	2004		2003	
	% of interest held	BD '000	% of interest held	BD '000
Bahrain Commercial Facilities Company B.S.C. (Incorporated in the Kingdom of Bahrain)	20.25	5,812	20.25	5,081

9 Interest receivable and other assets

	2004 BD '000	2003 BD '000
Interest receivable	5,143	6,362
Collateral pending sale	828	1,143
Accounts receivable	1,338	767
Positive fair value of derivatives (Note 25)	1,134	1,214
Advance tax	348	3,395
Deferred tax	421	434
Prepaid expenses	497	387
Other	1,582	286
	11,291	13,988

10 Borrowings under repurchase agreements

The proceeds from assets sold under repurchase agreements, at the year-end, amounted to BD 72.176 million (2003: BD 3.477 million). The assets sold under repurchase agreements were non trading investment securities of the Group amounting to BD 67.382 million (2003: BD 3.477 million).

11 Term loans

The term loans were unsecured facilities obtained for general financing purposes and comprised:

			Carrying amount	
Amount of facility US$ '000	Rate of interest	Maturity (Year)	2004 BD '000	2003 BD '000
100,000	Libor + 0.50%	2004	-	37,700
			-	37,700

12 Medium term deposits from banks

The medium term deposits were obtained for general financing purposes and comprised:

Amount of facility US$ '000	Rate of interest	Maturity (Year)	Carrying amount 2004 BD '000	Carrying amount 2003 BD '000
125,000	Libor + 0.485%	2006	47,125	47,125
125,000	Libor + 0.425%(*)	2009	47,125	-
	Libor + 0.450% (*)			-
			94,250	47,125

(*) The rate of interest is LIBOR plus 0.425% for first three years and LIBOR plus 0.45% for the fourth and fifth years.

13 Interest payable and other liabilities

	2004 BD '000	2003 BD '000
Interest payable	4,941	7,592
Accounts payable	6,953	3,776
Accrued expenses	8,897	6,249
Taxation	-	3,270
Negative fair value of derivates (Note 25)	1,105	1,271
Other	1,321	871
	23,217	23,029

14 Share capital and treasury stock

	2004 BD '000	2003 BD '000
Share Capital		
Authorised:		
1,000,000,000 shares of BD 0.100 each	100,000	100,000
Issued and fully paid:		
569,062,500 shares of BD 0.100 each	56,906	56,906

Treasury stock

Treasury stock represents the purchase by the Bank of its own shares. At the end of the year, the Bank held 4,369,666 shares (2003: 4,369,666 shares) of its own shares. Treasury stock does not carry the right to vote or to dividends.

15 Reserves

Statutory reserve

The Statutory Reserve has been created in accordance with the Bahrain Commercial Companies Law. The Bank transfers 10% of its annual profits to its Statutory Reserve till such time as the Reserve equals 50% of the issued share capital of the Bank. The Reserve is not available for distribution, except in circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Bahrain Monetary Agency.

General reserve

The general reserve has been built up in accordance with the provisions of the Bank's articles of association and underlines the shareholders' commitment to enhance the strong equity base of the Bank. The general reserve is a distributable reserve, subject to the approval of the Bahrain Monetary Agency.

16 Cumulative changes in fair values

	2004 BD '000	2003 BD '000
Available-for-sale investments		
At 1 January	4,370	134
Realised in the year	(3,489)	(2,515)
Change in unrealised fair values during the year	12,823	6,751
At 31 December	13,704	4,370
Cash flow hedges		
At 1 January	(384)	(720)
Change in unrealised fair values during the year	(63)	718
Change in unrealised fair values - associated company	189	(382)
At 31 December	(258)	(384)
	13,446	3,986

17 Proposed appropriations

	2004 BD '000	2003 BD '000
Dividend	19,764	16,941
Directors' remuneration	260	260
Donations	600	600
	20,624	17,801

The directors have proposed a cash dividend of 35% being BD 0.035 per share (2003: BD 0.030 per share) to be applied to the shares in issue, net of treasury stock, as of the balance sheet date.

The above appropriations will be submitted for formal approval at the Annual General Meeting to be held on 27 February 2005.

18 Interest income

	2004 BD '000	2003 BD '000
Treasury bills	1,508	1,348
Deposits and due from banks and other financial institutions	4,087	4,053
Loans and advances to customers	35,878	29,974
Non trading investment securities	9,311	11,062
	50,784	46,437

19 Interest expense

	2004 BD '000	2003 BD '000
Deposits and due to banks and other financial institutions	9,948	8,847
Term loans	139	704
Customers' current, savings and other deposits	11,172	10,809
	21,259	20,360

20 Other operating income

	2004 BD '000	2003 BD '000
Fees and commission income	12,508	13,625
Fees and commission expense	(1,780)	(1,377)
	10,728	12,248
Dividend income	2,536	2,193
Realised gain on non-trading investments	6,013	2,633
Income from managed funds	855	604
Trading income	(96)	702
Gain on foreign exchange	1,389	1,261
Other	986	709
	11,683	8,102
	22,411	20,350

21 Basic earnings per share

Basic earnings per share at the year end are calculated by dividing the net profit for the year by the weighted average number of shares outstanding during the year as follows:

	2004	2003
Net profit for the year (BD '000)	25,678	23,310
Weighted average number of shares, net of treasury stock, outstanding during the year	564,692,834	564,692,834
Basic earnings per share (BD)	0.045	0.041

No figure for diluted earnings per share has been presented as the Group has not issued any instruments which would have an impact on earnings per share when exercised.

22 Segmental information

Primary segment information

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

Retail banking – Principally handling individual customer deposits and providing consumer finance type loans, overdrafts, credit facilities and funds transfer facilities, card businesses and foreign exchange.

Corporate banking – Principally handling loans and other credit facilities, deposit and current accounts for corporate and institutional customers in Bahrain.

International banking – Principally handling loans and other credit facilities, deposit and current accounts for international corporate and institutional customers. This also covers the operations of the overseas units.

Investment, treasury and other activities – Principally providing money market, trading and treasury services as well as the management of the Group's funding operations. Investment activities involve handling investments in local and international markets, investment advisory services and funds management.

These segments are the basis on which the Group reports its primary segment information. Transactions between segments are conducted at estimated market rates on an arm's length basis. Interest is charged/credited to business segments based on a transfer pricing rate which approximates the marginal cost of funds on a matched funded basis.

22 Segmental information (continued)

Primary segment information (continued)

Segment information for the year ended 31 December 2004 was as follows:

	Retail banking BD '000	Corporate banking BD '000	International banking BD '000	Investment, treasury and other activities BD '000	Elimination BD '000	Total BD '000
External revenue	20,842	11,568	20,771	20,014		73,195
Inter- segmental revenue	5,104	5,169	1,609	17,775	(29,657)	-
Total revenue	25,946	16,737	22,380	37,789	(29,657)	73,195
Segment result	8,569	4,157	2,487	9,214		24,427
Common costs						-
Income from associate						1,251
Net profit for the year						25,678
Segment assets	156,274	268,904	566,219	409,493		1,400,890
Investment in associated company						5,812
Common assets						14,073
Total assets						1,420,775
Segment liabilities	290,531	328,852	386,181	246,240		1,251,804
Common liabilities						11,193
Total liabilities						1,262,997

Segment information for the year ended 31 December 2003 was as follows:

	Retail banking BD '000	Corporate banking BD '000	International banking BD '000	Investment, treasury and other activities BD '000	Elimination BD '000	Total BD '000
External revenue	18,123	10,938	21,152	16,574		66,787
Inter- segmental revenue	4,291	4,302	1,187	16,983	(26,763)	-
Total revenue	22,414	15,240	22,339	33,557	(26,763)	66,787
Segment result	6,519	7,967	3,510	5,274		23,270
Common costs						(1,094)
Income from associate						1,134
Net profit for the year						23,310
Segment assets	146,349	220,222	518,687	413,981		1,299,239
Investment in associated company						5,081
Common assets						9,298
Total assets						1,313,618
Segment liabilities	279,931	279,704	390,579	207,840		1,158,054
Common liabilities						13,312
Total liabilities						1,171,366

22 Segmental information (continued)

Secondary segment information

Although the management of the Group is based primarily on business segments, the Group operates in two geographic markets; Middle East, which is designated as Regional, and North America, European Union countries, Asia and others, which are designated as International. The geographical analysis of operating income, segment results, total assets and total liabilities, is based primarily upon the domicile of the customer or the investment.

Geographical areas:	Regional		International		Total	
	2004 BD '000	2003 BD '000	2004 BD '000	2003 BD '000	2004 BD '000	2003 BD '000
Operating income before provisions	38,981	35,453	12,955	10,974	51,936	46,427
Total assets	1,080,465	1,049,460	340,310	264,158	1,420,775	1,313,618

23 Cash and cash equivalents

Cash and cash equivalents included in the consolidated statement of cash flows include the following balance sheet amounts:

	2004 BD '000	2003 BD '000
Cash and balances with Central Bank	16,417	23,142
Treasury bills	19,932	33,462
Deposits and due from banks and other financial institutions	138,864	109,596
Cash and cash equivalents	175,213	166,200

24 Related party transactions

Certain related parties (principally the major shareholders, associated company, directors and senior management of the Group, their families and companies of which they are principal owners) were customers of the Group in the ordinary course of business. The transactions with these parties were made on substantially the same terms, including interest rates, as those prevailing at the same time for comparable transactions with unrelated parties and did not involve more than a normal amount of risk.

Amounts outstanding as of the balance sheet date in respect of transactions entered into with related parties were as follows:

	2004 BD '000	2003 BD '000
Loans and advances to customers	10,589	9,879
Non-trading investment securities	681	639
Deposits	152,586	166,181
Contingent liabilities	1,877	1,877

The income and expenses in respect of related parties included in the consolidated income statement are as follows:

	2004 BD '000	2003 BD '000
Interest income on loans and advances to customers	166	15
Gain on non trading investment securities	42	73
Interest expense on deposits	2,728	2,052

25 Derivatives

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instrument, reference rate or index. Derivative instruments include forwards, futures, swaps and options.

The table below shows the positive and negative fair values of derivative financial instruments together with the notional amounts analysed by the term to maturity. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at year end and are neither indicative of the market risk nor credit risk.

31 December 2004

	Positive fair value value BD '000	Negative fair value value BD '000	Notional amount Total BD '000	Notional amounts by term to maturity: within 3 months BD '000	3 – 12 months BD '000	1 – 5 years BD '000
Derivatives held for trading:						
Interest rate swaps	70	75	25,803	-	25,803	-
Forward foreign exchange contracts	754	645	44,464	13,371	31,093	-
Options	24	17	3,800	3,800	-	-
Derivatives held as fair value hedges:						
Interest rate swaps	171	179	17,154	-	8,426	8,728
Forward foreign exchange contracts	101	110	66,183	65,006	1,177	-
Derivatives held as cash flow hedges:						
Interest rate swaps	14	79	71,819	-	28,275	43,544
	1,134	1,105	229,223	82,177	94,774	52,272

31 December 2003

	Positive fair value value BD '000	Negative fair value value BD '000	Notional amount Total BD '000	Notional amounts by term to maturity: within 3 months BD '000	3 – 12 months BD '000	1 – 5 years BD '000
Derivatives held for trading:						
Interest rate swaps	187	199	43,963	4,126	15,080	24,757
Forward foreign exchange contracts	409	292	54,927	26,118	28,809	-
Options	171	146	15,104	13,973	1,131	-
Interest rate futures	37	10	18,550	-	18,550	-
Derivatives held as fair value hedges:						
Interest rate swaps	226	470	8,426	-	-	8,426
Forward foreign exchange contracts	184	152	110,602	110,602	-	-
Derivatives held as cash flow hedges:						
Interest rate swaps	-	2	37,700	37,700	-	-
	1,214	1,271	289,272	192,519	63,570	33,183

25 Derivatives (continued)

Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and interest rate futures are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. Forward rate agreements are effectively tailor-made interest rate futures which fix a forward rate of interest on a notional loan, for an agreed period of time starting on a specified future date.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency. For currency swaps, fixed or floating interest payments and notional amounts are exchanged in different currencies.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period. The Group does not engage in the writing of options.

Derivatives held or issued for trading purposes

Most of the Group’s derivative trading activities relate to back to back customer deals. In addition, the Group takes certain foreign exchange positions with the expectation of profiting from favourable movements in prices, rates or indices.

Derivatives held or issued for hedging purposes

The Group has put in place systems for the measurement and management of risk. Part of the risk management process involves managing the Group’s exposure to fluctuations in foreign exchange rates (currency risk) and interest rates through asset and liability management activities. It is the Group’s policy to reduce its exposure to currency and interest rate risks to acceptable levels as determined by the Board of Directors. For strategies adopted to manage interest rate and currency risk, please refer notes 30 and 31 respectively.

As part of its asset and liability management the Group uses derivatives for hedging currency, interest rate and cash flow risks. This is achieved by hedging specific financial instruments, forecasted transactions as well as strategic hedging against overall balance sheet exposures. In all such cases the objective of hedging relationship, details of the hedged item and hedging instrument are documented and the transactions are accounted for as fair value or cash flow hedges, as the case may be.

Since strategic hedging does not qualify for special hedge accounting, the related derivatives are accounted for as trading instruments.

26 Commitments and contingent liabilities

Credit-related commitments

Credit-related commitments include commitments to extend credit, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Group’s customers.

Commitments to extend credit represents contractual commitments to make loans and revolving credits. Commitments generally have fixed expiration dates or other termination clauses. Since commitments may expire without being drawn upon, the total contracted amounts do not necessarily represent future cash requirements.

Letters of credit, guarantees (including standby letters of credit) and acceptances commit the Group to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract. Standby letters of credit, which are included under guarantees, would have market risk if issued or extended at a fixed rate of interest. However, these contracts are primarily made at a floating rate.

26 Commitments and contingent liabilities (continued)

Credit-related commitments (continued)

The Group has the following credit related commitments:

	2004 BD '000	2003 BD '000
Commitments on behalf of customers:		
Letters of credit	45,146	40,287
Guarantees	145,246	125,953
Acceptances	7,553	9,254
	197,945	175,494
Irrevocable commitments		
Undrawn loan commitments	44,641	34,711
Commitments in respect of investments	4,083	8,418
	48,724	43,129
	246,669	218,623

As at 31 December 2004, the Group also has capital commitments of BD 1.33 million (31 December 2003: Nil).

	2004 BD '000	2003 BD '000
Irrecoverable commitments to extend credit:		
Original term to maturity of one year or less	14,009	28,411
Original term to maturity of more than one year	34,715	14,718
	48,724	43,129

27 Credit risk and concentration of credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographical region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location.

The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties, diversification of lending activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses, and by obtaining security when appropriate. In addition to monitoring credit limits, the Group manages the credit exposure by entering into netting agreements and collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposure.

All policies relating to credit are reviewed and approved by the Board of Directors. An Executive Committee, consisting of six senior members of the Board of Directors, reviews and approves larger credits. In addition, all larger credits in excess of approval authority of the Executive Committee are approved by the Board of Directors.

Credit limits are established for all customers after a careful assessment of their creditworthiness and approval as per the levels of authority (approved by the Executive Committee and the Board of Directors). These are also subject to the Bahrain Monetary Agency's large credit exposure limit criteria. Standard procedures, outlined in the Bank's Credit Procedures Manual, require that all credit proposals be subjected to a detailed screening by a Designated Credit Officer, who is part of a three member approval committee.

Details of the composition of the loans, advances and overdrafts portfolio are set out in note 6 to the consolidated financial statements.

Details of the industry sector analysis and the geographical distribution of assets, liabilities and off balance sheet items are set out in note 28 to the consolidated financial statements.

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Group. The Group's derivative contracts are generally entered into with other financial institutions.

28 Concentration of assets, liabilities and off balance sheet items

The distribution of assets, liabilities and off-balance sheet items by geographic region and industry sector was as follows:

	2004			2003		
	Assets BD '000	Liabilities BD '000	Off balance sheet items BD '000	Assets BD '000	Liabilities BD '000	Off balance sheet items BD '000
Geographical region:						
Gulf Co-operation Council Countries	1,080,465	1,104,307	152,346	957,153	1,064,855	139,295
North America	85,765	3,503	4,200	61,297	4,421	7,494
European Union Countries	132,218	138,561	52,959	153,600	63,199	50,535
Asia	80,659	13,894	37,076	112,835	37,686	20,397
Others	41,668	2,732	1,418	28,733	1,205	902
	1,420,775	1,262,997	247,999	1,313,618	1,171,366	218,623
Industry sector:						
Trading and manufacturing	289,346	60,524	62,334	197,572	80,985	46,506
Banks and other financial institutions	513,874	456,433	124,040	479,623	444,945	107,384
Construction and real estate	91,307	15,009	23,689	137,645	10,597	27,965
Government and public sector	223,139	206,238	-	143,187	151,338	18,935
Individuals	222,135	318,615	41	168,006	319,159	1,623
Others	80,974	206,178	37,895	187,585	164,342	16,210
	1,420,775	1,262,997	247,999	1,313,618	1,171,366	218,623
Month end average	1,400,616	1,255,953	220,787	1,271,192	1,141,297	496,162

29 Market risk

Market risk is defined as the risk of losses in the Group's on or off balance sheet positions arising from movements in the interest rates, foreign exchange rates and equity prices.

The Group has clearly defined policies for conducting investment (including trading investments) and foreign exchange business which stipulates limits for these activities. Investments are made strictly in accordance with investment acceptance criteria, which ensures that the investments are qualitative and liquid. The Group does not undertake any commodity trading activities. For management of market risk arising from movement in interest rates, refer note 30.

The Bank computes Value at Risk (VaR) for measuring general market risk in trading positions. The VaR model is approved by the Bahrain Monetary Agency. The capital allocated for market risk is based on the VaR calculated at a 99 percent confidence level on a 10 day holding period.

The Group's Risk Management Department conducts back testing in accordance with the Market Risk Capital Adequacy Regulations issued by the Bahrain Monetary Agency to ensure that the VaR model and assumptions used for computing VaR numbers are reliable. The Bank also conducts stress testing to identify events or influences that could greatly impact material trading positions taken by the Bank.

30 Interest rate risk management

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the value of financial instruments. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or reprice in a given period. The Group manages this risk by reviewing the repricing of assets and liabilities on a weekly basis.

The Board has established levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Positions are monitored and hedging strategies used to ensure positions are maintained within the limits established by the Board. The Group uses interest rate swaps and interest rate futures to hedge against the interest rate risk arising from specifically identified fixed interest rate assets.

30 Interest rate risk management (continued)

The Group's interest rate sensitivity position, based on the earlier of contractual repricing or maturity dates, is as follows:

As of 31 December 2004

	Less than 1 month BD '000	1 month to 3 months BD '000	3 months to 1 year BD '000	1 year to 5 years BD '000	Over 5 years BD '000	Not exposed to interest rate risk BD '000	Total BD '000
Cash and balances with central banks	-	-	-	-	-	35,682	35,682
Treasury bills	9,965	9,965	5,505	-	-	-	25,435
Trading investments	-	-	-	-	-	2	2
Deposits and due from banks and other financial institutions	165,642	14,258	6,900	-	-	353	187,153
Loans and advances to customers	336,406	114,480	135,921	66,769	97,908	13,205	764,689
Non-trading investment securities	30,311	128,818	133,477	17,627	19,587	46,311	376,131
Investment in associated company	-	-	-	-	-	5,812	5,812
Interest receivable and other assets	-	-	-	-	-	11,291	11,291
Premises and equipment	-	-	-	-	-	14,580	14,580
Total assets	542,324	267,521	281,803	84,396	117,495	127,236	1,420,775
Deposits and due to banks and other financial institutions	123,671	80,025	11,228	-	-	13,928	228,852
Borrowings under repurchase agreements	-	72,176	-	-	-	-	72,176
Term loans	-	-	-	-	-	-	-
Medium term deposits from banks	-	47,125	47,125	-	-	-	94,250
Customers' current, savings and other deposits	472,690	159,695	100,118	11,452	2,680	97,867	844,502
Interest payable and other liabilities	-	-	-	-	-	23,217	23,217
Shareholders ' equity	-	-	-	-	-	157,778	157,778
Total liabilities and shareholders' equity	596,361	359,021	158,471	11,452	2,680	292,790	1,420,775
On-balance sheet gap	(54,037)	(91,500)	123,332	72,944	114,815		
Off-balance sheet gap	23,411	54,488	(25,545)	(52,354)	-		
Total interest rate sensitivity gap	(30,626)	(37,012)	97,787	20,590	114,815		
Cumulative interest rate sensitivity gap	(30,626)	(67,638)	30,149	50,739	165,554		

30 Interest rate risk management (continued)

As of 31 December 2003

	Less than 1 month BD '000	1 month to 3 months BD '000	3 months to 1 year BD '000	1 year to 5 years BD '000	Over 5 years BD '000	Not exposed to interest rate risk BD '000	Total BD '000
Cash and balances with central banks	1,680	-	-	-	-	40,466	42,146
Treasury bills	18,335	20,434	34,198	-	-	-	72,967
Trading investments	-	-	-	-	4,454	-	4,454
Deposits and due from banks and other financial institutions	34,462	51,752	71,955	-	-	9,883	168,052
Loans and advances to customers	239,189	128,350	117,307	96,607	71,105	6,609	659,167
Non-trading investment securities	22,525	106,721	69,751	63,482	23,085	46,826	332,390
Investment in associated company	-	-	-	-	-	5,081	5,081
Interest receivable and other assets	-	-	-	-	-	13,988	13,988
Premises and equipment	-	-	-	-	-	15,373	15,373
Total assets	316,191	307,257	293,211	160,089	98,644	138,226	1,313,618
Deposits and due to banks and other financial institutions	234,890	29,418	8,533	6,337	-	8,682	287,860
Borrowings under repurchase agreements	3,477	-	-	-	-	-	3,477
Term loans	-	18,850	18,850	-	-	-	37,700
Medium term deposits from banks	-	-	47,125	-	-	-	47,125
Customers' current, savings and other deposits	472,913	143,354	67,336	6,654	21,561	60,357	772,175
Interest payable and other liabilities	-	-	-	-	-	23,029	23,029
Shareholders ' equity	-	-	-	-	-	142,252	142,252
Total liabilities and shareholders' equity	711,280	191,622	141,844	12,991	21,561	234,320	1,313,618
On-balance sheet gap	(395,089)	115,635	151,367	147,098	77,083		
Off-balance sheet gap	-	5,655	(2,771)	(2,884)	-		
Total interest rate sensitivity gap	(395,089)	121,290	148,596	144,214	77,083		
Cumulative interest rate sensitivity gap	(395,089)	(273,799)	(125,203)	19,011	96,094		

The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is a historical rate for a fixed rate instrument carried at amortised cost and a current market rate for a floating rate instrument or an instrument carried at fair value. The effective interest rates by major currencies for each of the monetary financial instruments are as follows:

30 Interest rate risk management (continued)

	31 December 2004 Effective interest rate %			31 December 2003 Effective interest rate %		
	BD	KD	US$	BD	KD	US$
Assets						
Treasury bills	1.3	2.3	-	1.1	2.7	-
Deposits and due from banks and financial institutions	1.5	2.7	1.5	1.3	2.3	1.3
Loans and advances to customers (a)	5.8	4.8	2.3	6.0	5.0	2.1
Non-trading investment securities	1.7	2.8	3.0	1.4	2.8	3.8
Liabilities						
Deposits and due to banks and other financial institutions	1.3	2.4	1.7	0.8	2.6	1.1
Term loans	-	-	-	-	-	1.8
Medium term deposits with banks	-	-	2.0	-	-	1.7
Customers' current, savings and other deposits (b)	0.7	0.9	1.5	0.7	1.5	1.4

(a) The effective interest rate for loans and advances to customers has been computed by excluding non-performing loans.

(b) The effective interest rates for deposits have been computed by excluding non-interest bearing accounts which form a small proportion of such deposits.

31 Currency risk

The functional currency of the Group is the Bahraini Dinar.

The Group had the following significant net exposures denominated in foreign currencies as of the balance sheet date:

	2004 BD '000 equivalent long (short)	2003 BD '000 equivalent long (short)
US dollars	66,816	60,853
Euro	(1,449)	302
G.C.C. currencies	164	(163)
Others	(161)	478

As the Bahraini Dinar is pegged to the US Dollar, positions in US Dollars are not considered to represent significant currency risk. The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on a daily basis to ensure that they are maintained within established limits. The Group uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks.

32 Equity price risk

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

33 Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. To guard against this risk, management have diversified funding sources, assets are managed with liquidity in mind and liquidity positions are monitored, maintaining a healthy balance of cash, cash equivalents, and readily marketable securities. In addition, the Group maintains various statutory deposits with central banks and has taken lines of credit from various banks and financial institutions.

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

As of 31 December 2004

	Less than 1 month BD '000	1 month to 3 months BD '000	3 months to 1 year BD '000	1 – 5 years BD '000	5 – 10 years BD '000	10 – 20 years BD '000	More than 20 years BD '000	Undated BD '000	Total BD '000
Assets									
Cash and balances with central banks	16,133	284	441	599	-	-	10	18,215	35,682
Treasury bills	9,965	9,967	5,503	-	-	-	-	-	25,435
Trading investments	2	-	-	-	-	-	-	-	2
Deposits and due from banks and other financial institutions	165,994	14,258	6,901	-	-	-	-	-	187,153
Loans and advances to customers	144,570	52,505	85,946	256,566	186,217	38,885	-	-	764,689
Non-trading investment securities	1,736	20,463	103,064	116,625	94,704	1,557	50	37,932	376,131
Investment in associated company	-	-	-	-	-	-	-	5,812	5,812
Interest receivable and other assets	6,707	1,382	837	2,133	-	31	-	201	11,291
Premises and equipment	-	-	-	-	-	-	-	14,580	14,580
Total assets	345,107	98,859	202,692	375,923	280,921	40,473	60	76,740	1,420,775
Liabilities									
Deposits and due to banks and other financial institutions	137,599	80,025	11,228	-	-	-	-	-	228,852
Borrowings under repurchase agreements	-	72,176	-	-	-	-	-	-	72,176
Term loans	-	-	-	-	-	-	-	-	-
Medium term deposits from banks	-	-	-	94,250	-	-	-	-	94,250
Customers' current, savings and other deposits	570,554	159,695	100,118	11,452	2,683	-	-	-	844,502
Interest payable and other liabilities	22,203	-	705	205	-	-	-	104	23,217
Total liabilities	730,356	311,896	112,051	105,907	2,683	-	-	104	1,262,997

33 Liquidity risk (continued)

As of 31 December 2003

	Less than 1 month BD '000	1 month to 3 months BD '000	3 months to 1 year BD '000	1 – 5 years BD '000	5 – 10 years BD '000	10 – 20 years BD '000	More than 20 years BD '000	Undated BD '000	Total BD '000
Assets									
Cash and balances with central banks	23,432	170	670	430	14	-	-	17,430	42,146
Treasury bills	18,338	53,401	1,228	-	-	-	-	-	72,967
Trading investments	-	-	-	-	919	3,535	-	-	4,454
Deposits and due from banks and other financial institutions	38,643	57,676	71,733	-	-	-	-	-	168,052
Loans and advances to customers	101,722	76,924	47,964	258,607	146,463	27,487	-	-	659,167
Non-trading investment securities	3,353	22,655	57,254	125,257	89,582	-	-	34,289	332,390
Investment in associated company	-	-	-	-	-	-	-	5,081	5,081
Interest receivable and other assets	8,813	278	501	3,478	48	61	-	809	13,988
Premises and equipment	-	-	-	-	-	-	-	15,373	15,373
Total assets	194,301	211,104	179,350	387,772	237,026	31,083	-	72,982	1,313,618
Liabilities									
Deposits and due to banks and other financial institutions	240,786	32,713	8,063	6,298	-	-	-	-	287,860
Borrowings under repurchase agreements	3,477	-	-	-	-	-	-	-	3,477
Term loans	-	-	37,700	-	-	-	-	-	37,700
Medium term deposits from banks	-	-	-	47,125	-	-	-	-	47,125
Customers' current, savings and other deposits	429,489	219,066	85,467	16,990	21,163	-	-	-	772,175
Interest payable and other liabilities	18,482	97	149	3,558	574	-	-	169	23,029
Total liabilities	692,234	251,876	131,379	73,971	21,737	-	-	169	1,171,366

34 Legal risk

Legal risk is the risk relating to losses due to legal or regulatory action that invalidates or otherwise precludes performance by the end user or its counterparty under the terms of the contract or related netting agreements. The Group has developed sufficient preventive controls and formalised procedures to identify legal risks so that potential losses arising from non-adherence to laws and regulations, negative publicity, etc. are avoided. The Group also has well established legal procedures to scrutinise product offerings and manage risks arising out of its transactions.

35 Funds under management

Funds under management at the year-end amounted to BD 54.7 million (31 December 2003: BD 44.0 million). These assets are held in a fiduciary capacity and are not included in the consolidated balance sheet.

36 Fair value of financial instruments

The table below sets out the estimated carrying values and fair values of those on and off balance sheet financial instruments where fair values are materially different from carrying amounts in the consolidated financial statements:

	31 December 2004			31 December 2003		
	Carrying value BD '000	Fair value BD '000	Difference BD '000	Carrying value BD '000	Fair value BD '000	Difference BD '000
Financial assets						
Non-trading investment securities	179,535	179,561	26	152,114	154,757	2,643

As explained in note 7, included under non-trading investments are unquoted investments amounting to BD 33.794 million (2003: BD 12.092 million) for which fair value cannot be reliably determined.

In addition, due to time and cost benefit constraints and the lack of a secondary market, it is not practicable to determine the fair value of loans and advances to customers.

37 Capital adequacy

The risk asset ratio calculated in accordance with the capital adequacy guidelines approved by the Bahrain Monetary Agency, for the Group is as follows:

	2004 BD '000	2003 BD '000
Capital base:		
Tier 1 capital	110,581	105,325
Tier 2 capital	49,531	32,582
Total capital base (a)	160,112	137,907
Credit risk weighted exposure:		
On-balance sheet	748,459	733,609
Off-balance sheet	94,228	83,196
Total	842,687	816,805
Market risk weighted exposure:		
On-balance sheet	-	-
Off-balance sheet	7,993	7,300
Total	7,993	7,300
Total risk weighted exposure (b)	850,680	824,105
Capital adequacy (a/b * 100)	18.82%	16.73%
Minimum requirement	12%	12%

38 Legal claims

As at 31 December 2004, there were 17 legal suits pending against the Group aggregating BD 1.341 million (2003: BD 1.297 million). Based on the opinion of the Group's legal advisors, the management believes that no liability is likely to arise from these suits and does not consider it necessary to carry any provisions in this regard.

39 Deposit protection scheme

Deposits held with the Bahrain operations of the Group are covered by the Deposit Protection Scheme (the Scheme) established by the Bahrain Monetary Agency regulation concerning the establishment of Deposit Protection Scheme and Deposit Protection Board. No liability is due until one of the member commercial banks of the Scheme is unable to meet its deposit obligations.

40 Comparatives

The comparative figures in these financial statements for the previous year have been reclassified where necessary to conform with the current year's presentation. Such reclassification has not affected the previously reported net income, total assets, total liabilities and shareholders' equity of the Group.