BBK

بنك البحرين والكويت

Annual Report 2005

www.bbkonline.com

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

H.H. Sheikh Sabah Al Ahmed Al Sabah
The Amir of the State of Kuwait

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

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Our Vision

BBK will be the premier regional financial services enterprise in providing superior products and services of high quality through innovation, technology and 'life long' client relationships.

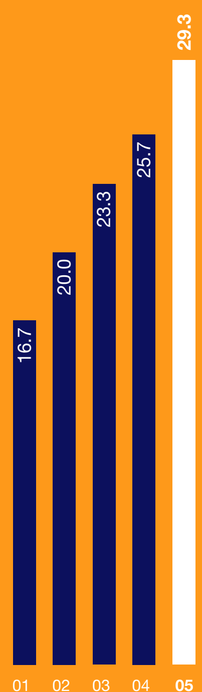
The Bank will expand its overseas presence in more locations in which it chooses to operate in order to satisfy the diversified needs of clients. We believe clients are the driving force in everything we do. We will not compromise on our absolute commitment to providing the very best in client service.

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.

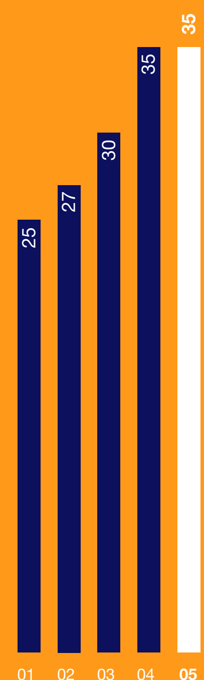
We are determined to utilise 'cutting edge' technology which we recognise as most critical in supporting our short, medium and long-term business objectives.

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.

Financial Highlights

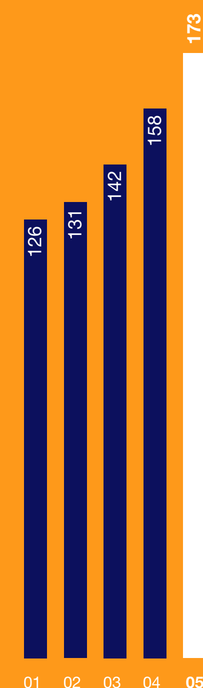


Net profit for the year
BD millions



Dividend
Per cent

Cost / income
Per cent



Equity
BD millions

	2001	2002	2003	2004	**2005**
Income Statement Highlights BD millions					
Net interest income	23.7	25.5	26.1	29.5	**35.7**
Other income	13.6	16.2	21.4	23.6	**20.2**
Operating expenses	18.9	19.9	22.0	23.2	**23.8**
Net profit for the year	16.7	20.0	23.3	25.7	**29.3**
Dividend	25%	27%	30%	35%	**35%**
Financial Statement Highlights BD millions					
Total assets	1,101	1,215	1,314	1,421	**1,499**
Net loans	481	537	659	765	**795**
Investments	328	386	415	407	**491**
Deposits	749	760	823	890	**917**
Term loans	85	85	38	-	**-**
Medium term deposits from banks	-	-	47	94	**94**
Equity	126	131	142	158	**173**
Profitability					
Earnings per share (fils)	30	35	41	45	**52**
Cost / Income	50.70%	47.70%	46.30%	43.70%	**42.57**%
Return on average assets	1.50%	1.66%	1.83%	1.83%	**1.86**%
Return on average equity	14.40%	16.10%	17.80%	17.80%	**18.15**%
Profit per employee (BD)	24,117	28,341	32,739	36,578	**41,769**
Capital					
Capital adequacy	17.10%	16.80%	16.73%	18.82%	**19.57**%
Equity / Total assets	11.40%	10.80%	10.80%	11.11%	**11.55**%
Debt / Equity	67.40%	64.70%	59.63%	59.73%	**54.36**%
Liquidity and Business Indicators					
Loans & advances / Total assets	43.70%	44.20%	50.20%	53.82%	**53.04**%
Investments (excluding T bills) / Total assets	26.40%	26.00%	25.70%	26.47%	**31.14**%
Liquid assets / Total assets	31.60%	34.10%	32.40%	29.42%	**33.84**%
Non inter-bank deposits / Loans & investments	95.40%	87.10%	86.04%	82.29%	**76.46**%
Net interest margin	2.41%	2.45%	2.30%	2.29%	**2.48**%
Number of employees	694	706	712	702	**701**

Chairman's Statement

I would like to express my great sadness on learning of the death of His Highness Shaikh Jaber Al Ahmed Al Sabah, the Amir of Kuwait. On behalf of the Board of Directors, and the management and staff of BBK, I offer my sincere condolences to the Ruling Family and the People of Kuwait.

Dear Shareholders
On behalf of the Board of Directors, it is my privilege to present the annual report of BBK for the year ended 31 December 2005. I am pleased to report that this proved to be another successful year for your Bank, marked by record financial results, significant strategic progress, strong operational achievements, and major organisational developments. It is particularly encouraging to note that despite an increasingly competitive market environment, BBK's overall performance exceeded our expectations for the year.

Financial performance

In 2005, BBK recorded its highest ever net profit of BD 29.3 million, eclipsing the previous record of BD 25.7 million the previous year, which included a one-off contribution of BD 2.92 million from the sale of a strategic investment. If excluded for the purpose of comparison, net profit for 2005 increased by BD 6.5 million or 29 per cent, compared to 2004. Total assets grew by 5.5 per cent to BD 1.499 million while equity rose by 10 per cent to BD 173 million.

Due to the continued focus on containing costs, operating expenses for 2005 (excluding provisions) rose only marginally by BD 0.55 million or 2.4 per cent, compared to the previous year. As a result of proactive remedial management and credit risk management, BBK was able to further reduce its net provisions to BD 2.3 million, compared to BD 4.3 million in 2004.

The Bank's consolidated profits have resulted in an increase in return on average equity from 17.8 per cent in 2004 to 18.1 per cent in 2005. At the end of 2005, the market capitalisation of BBK stood at BD 407 million, while its share price of 715 fils maintained the high growth levels achieved in 2004, further protecting the value of our shareholders' investment.

During 2005, BBK successfully continued to diversify its sources of funding by mandating HSBC and Citibank – out of a total of nine bidding banks – to arrange a five-year Euro Medium Term Deposit Note (EMTDN) with a total facility of up to US$ 1 billion. This marks the first time that a local commercial bank has tapped the international bond market. The first tranche of between US$ 300 and US $ 500 million is due to be launched during the first quarter of 2006, with an initial listing on the London Stock Exchange to be followed by subsequent listings on other European bourses such as Luxembourg. This EMTDN will provide BBK with a flexible and constantly available source of funding that can be drawn upon as and when needed, at a guaranteed fair market price, and will also involve a review of the Bank's long-term credit rating.

Economic and market background

These achievements took place against a backdrop of continued global recovery during 2005, underpinned by healthier market conditions, improved credit quality, renewed investor confidence, and strengthened manufacturing and trading activities. Concerns remain, however, over the long-term effects of rising oil prices, which have resulted in increasing current account imbalances by the major industrial nations, accompanied by tightening interest rates and fluctuating exchange rates.

Economic prospects for the GCC region remain robust, fuelled by higher oil production and prices, which have substantially enhanced liquidity levels. This has boosted public spending in major infrastructure and industrial projects, together with increased investment by the private sector – both domestic and foreign – in the region's equity markets and real estate, tourism and industrial sectors.

These developments had a positive impact on the regional financial services sector during 2005, with stock markets posting record gains, and banks and other institutions reporting record levels of business activity and profitability.


financial advice
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The banking industry witnessed increasing competition, with the entry of further new players – both conventional and Islamic – and intensified marketing activities by existing players to widen their customer base. In Bahrain, the progress of landmark developments such as Bahrain Financial Harbour and the World Trade Centre will help to enhance the Kingdom's status as a leading financial and business centre. At the same time, the quickening pace of major structural reforms in areas such as the economy, labour market, and education, will help to ensure sustainable long-term growth.

Strategic progress

A key strategic development in 2005 was the successful unveiling of BBK's new corporate identity and branding strategy under the single brand proposition of 'Brighter Banking'. This strongly reinforces our vision of a brighter future for all our stakeholders, and heralds a new era in banking at BBK – one that places customers at the very heart of our organisation. Our new branding also better reflects the evolution of BBK over the last 34 years into a dynamic, innovative and responsive financial services enterprise, with a growing regional presence.

During the year, the Board of Directors held two special meetings at which they reviewed recommendations from the Executive Management for evolving BBK's strategic direction, and approved a new three-year strategic plan for 2006 to 2008. Based on the Bank's vision, future strategy will focus on a number of key areas aimed at ensuring long-term consistent growth that will maintain our competitiveness and provide superior returns to our shareholders:

- Expand the size and scope of our core business activities,
- Consolidate our leadership in the delivery of technology-based financial services,
- Diversify our income streams and asset base,
- Enhance the ratio of gross income to operating expenses, and
- Identify new business opportunities and strategic alliances in the region.

Also during 2005, the Board concluded its review of the Bank's non-core business activities, as well as its operations outside the GCC region. In line with BBK's new strategic focus, the decision was taken to close BBK Financial Services and Al-Khaleej Islamic Investment Bank, while negotiations commenced for the disposal of the Bank's branch network in India. Underlining the Bank's new strategic approach, a Memorandum of Understanding was signed with Shamil Bank for the establishment of a new 50-50 joint-venture institution to meet the growing demand for Shari'a-compliant home financing solutions. This new institution, which is planned to become operational in the early part of 2006, will play an important role in further diversifying BBK's commercial banking activities and income streams.

Corporate governance

As a leading regional financial institution, BBK is totally committed to upholding the highest standards of corporate governance. During 2005, we conducted a comprehensive review of the Bank's policies and procedures to ensure full compliance with the latest rules from the Bahrain Monetary Agency (BMA) on issues such as business ethics, insider trading, and anti-money laundering. In this year's annual report for BBK, we have expanded the special section on additional disclosures to further improve the quality of our communications and the transparency of our reporting.

Once again, we welcome the latest BMA initiatives to improve the disclosure standards for the Kingdom's financial institutions and listed companies, and we fully support all endeavours that will enhance the reputation of Bahrain as the region's premier financial centre. In this respect, we welcome the newly-established Bahrain Credit Reference Bureau (BCRB), which commenced operations during the year. BCRB will help to set healthy parameters for banks and financial institutions to regulate their lending business, and also enhance their ability to make consumer credit decisions, especially in the areas of mortgages and professional loans.

Operational achievements

Throughout 2005, BBK continued to lead the way with new and innovative products and services for our customers. We finalised plans for the introduction of a new 'financial mall' concept to replace our traditional branches; launched a new mortgage scheme; added life cover to our Secura insurance product line; and further enhanced our e-banking services. We also concluded plans to spin off our Call Centre as an independent entity, providing services not just to BBK and Credimax clients, but also to other financial institutions and commercial organisations – a first for Bahrain.

As a major provider of corporate banking services in the Kingdom, BBK continued to assist clients with financing for a range of commercial, industrial and infrastructure projects. The Bank also successfully managed and arranged a BD 10 million five-year Floating Rate Bond issue for Bahrain Commercial Facilities Company.

Organisational developments

In support of the Bank's strategic and business objectives, a totally new core banking and branch automation system was put through initial tests towards the end of the year in readiness for full implementation in early 2006. Also during the year, we continued to strengthen the Bank's risk management and financial control framework, reviewed our business continuity plan, and further streamlined our policies and procedures. We also progressed plans for the introduction of the new Basel II capital adequacy guidelines to ensure that the necessary risk management framework, technology systems, data requirements, and human resources are in place, well ahead of the BMA's implementation deadline for Pillar 2 and 3 supervisory and disclosure requirements in 2007.

As ever, our people continue to be BBK's most important assets, and during 2005 we continued to place the highest priority on their professional development and personal welfare. The second group of graduates in our Management Trainees Programme commenced their training, while the first phase of BBK's new succession planning programme was completed, with potential successors identified for key positions.

Corporate social responsibility

Throughout 2005, BBK continued its longstanding contribution to the social well-being of the local communities in which we operate. The Bank provided extensive financial support for numerous charitable, medical, educational, scientific, environmental, cultural, sporting and social institutions and organisations.

Appreciations

Statutory elections for the Board of Directors took place in 2005, and I would like to take this opportunity to express my gratitude to two retiring members – Mr Rasheed Mohammed Al Maraj and Mr Saeed A. Karim Al Marzooq – whose hard work and diligence made a valuable contribution to the success of BBK during their tenure. I would also like to welcome three new incoming members – Mr Jamal Ali Al Hazeem, Mr Ali Hassan Meshari Al Bader, and Sh Khalifa bin Daij bin Khalifa Al Khalifa – with the certainty that they will serve the Bank with diligence and distinction.

On behalf of the Board of Directors, I would like to extend my best wishes and gratitude to His Majesty King Hamad bin Isa Al Khalifa, the King of Bahrain; His Highness Shaikh Jaber Al Ahmed Al Sabah, the late Amir of the State of Kuwait whose continuous support, wise leadership and guidance contributed immensely to the success of the Bank – especially its branch in Kuwait. May God rest his soul. I would also like to take this opportunity to extend my best wishes to the new Amir, His Highness Shaikh Sabah Al Ahmed Al Jaber Al Sabah, and wish him every success in further bolstering the development, prosperity and welfare of the State of Kuwait. Also, my appreciation to their respective governments and regulatory authorities for their professional advice and guidance.

I would also like to take this opportunity to convey my sincere thanks to our shareholders for their confidence and financial support; to our clients for their loyalty and trust; and to our management and staff for their dedication and hard work. Their collective contributions and steadfast support have ensured yet another successful year for BBK, and continue to provide us with renewed confidence for the future.





Murad Ali Murad
Chairman

Board of Directors

Hamad Ahmed Al Busairi

Yacoub Yousef Al Fulaij

Murad Ali Murad

Jassem Hasan Ali Zainal

Sh Mohammed bin Isa Al Khalifa

Mohammed Salahuddin

Abdulla Mohammed Al Sumait

Ali Hassan Meshari Al Bader

Sh Khalifa bin Daij bin Khalifa Al Khalifa

Jamal Ali Al Hazeem

Abdul Majeed Haji Al Shatti

Aref Saleh Khamis

Management Review

I am pleased to report that BBK enjoyed another successful and eventful year in 2005. Record results enhanced our reputation as a dynamic financial services enterprise, while key organisational initiatives represented a quantum leap in our quest to transform BBK into a truly people-oriented institution.

Improvements across our core business activities enabled BBK to post record net profits, grow our asset base, and enhance returns to our shareholders. At the same time, we improved our service to clients by introducing new and innovative products, expanding the range of delivery channels, and strengthening the Bank's operating infrastructure. We also responded to increasing market competition by continuing to diversify our operations by identifying and seizing new business opportunities, and forming new strategic alliances and business partnerships.

A key development in 2005 was undoubtedly the successful re-branding of BBK. Our new people-oriented proposition 'Brighter Banking' promises a bright new future for all our stakeholders. It heralds an important new chapter in the evolution of BBK as a trustworthy, welcoming, confident, innovative, and empowering organisation.

People

Our team has a key role to play in implementing BBK's new people-oriented brand proposition 'Brighter Banking'. As the human face of the Bank, our people are instrumental in retaining the trust and loyalty of our existing clients, and helping to forge enduring relationships with a new generation of clients. Throughout the year, therefore, we held a number of in-house workshops to reinforce BBK's new culture and values, and to introduce a new manual of client service quality standards that will guide the way we operate.

In line with BBK's emphasis on performance, the Bank's new performance management system was fully implemented during the year. This provides a consistent method for measuring and rewarding individual performance that is closely aligned to strategic and business objectives. Our Management Trainee Programme continued to produce excellent results, with the second group of graduates embarking upon a challenging curriculum of theoretical and practical training. Encouragingly, the first group of graduates from 2004 have successfully taken up permanent positions throughout the Bank, providing BBK with a growing cadre of young professionals from which to fill senior management positions in the future. Also during 2005, the first phase of BBK's succession planning programme was completed. An assessment centre was conducted where key positions were earmarked and assessed, and relevant development needs identified.

Clients

The financial sector in Bahrain is facing unprecedented levels of competition. This has been fuelled by the entry of new regional and international players, more aggressive marketing from existing conventional and Islamic players, and higher expectations from clients for new and innovative products and delivery channels and more responsive levels of service. Unveiled in 2005, BBK's new branding proposition 'Brighter Banking' will be used to spearhead the Bank's sharpened focus on client service as the only sustainable competitive differentiator in an increasingly saturated market.

To meet the new challenges of the **retail banking** sector, BBK embarked upon a major transformation of its traditional branches into 'financial malls' during the year. A first for a local commercial bank, these financial malls will be situated at prime locations and provide clients with a fully-fledged range of BBK financial services, as well as providing maximum levels of comfort and convenience. In addition, related services offered by strategic third party alliances will also be made available. The first of these newly constructed malls will open in Adliya in early 2006, followed by others in key residential and commercial locations across Bahrain.

Throughout 2005, BBK continued to lead the way with new and innovative products and services. In response to the Kingdom's booming real estate sector and the growing demand for residential and small commercial property financing, the Bank launched a new mortgage loans package. This is available for the first time in Bahrain to all nationalities, and offers a maximum borrowing limit of BD 350,000 with a repayment period of up to 25 years. In addition, BBK entered into an agreement with Pearl Development and Real Estate Company to provide mortgages for buyers of apartments at the US$ 250 million Abraj Al Lulu project in the centre of Manama. To cater for the growing number of home buyers seeking Islamic financing solutions, BBK also formed a joint-venture company – Sakana – with Shamil Bank of Bahrain to provide Shari'a-compliant mortgage loans. The new company is expected to become operational in the early part of 2006.

With the introduction of Life Secure in 2005, BBK expanded its Secura range of insurance products and services, which are provided in association with Bahrain Kuwait Insurance Company (BKIC). The addition of life assurance cover not only enhances BBK's overall bancassurance business but also provides beneficial cross-selling opportunities in conjunction with its mortgage activities. Also in 2005, BBK expanded its provision of Western Union money transfer services through additional post offices at key locations in the Kingdom.

In another significant development, BBK acted as the receiving bank for the Initial Public Offering (IPO) of Al Banader Hotel Company, the first IPO for a new Bahraini company for some considerable time. The BBK team successfully handled the large demand for this popular offering, which was substantially oversubscribed.

During 2005, the Bank's leading position in the provision of electronic services, via the www.bbkonline.com portal, was internationally recognised by the receipt of the World Summit Award 2005 for the best eContent in the Arab World. This portal, which has been re-designed to incorporate the new BBK brand personality, provides a host of new user-friendly and convenient features such as a personalised ePIN facility and the online transfer of funds. These and other innovative improvements contributed to an increase in BBK's online transactions by 50 per cent compared to 2004.

In early 2006, BBK's e-Call Centre will be spun off as a separate entity to address the growing local and regional market demand for third party inbound and outbound tele-services. The new company – Invita – will continue to meet the needs of BBK and CrediMax clients, as well as customers of other businesses and organisations across the Gulf region.

Following the establishment of the Bahrain Credit Reference Bureau (BCRB) in 2005, BBK successfully implemented all new procedures for processing consumer credit applications. The services of BCRB will provide BBK with a more accurate client financial history to support credit decisions, especially in the areas of mortgage and professional loans.

The introduction of new regulations by the BMA in 2005 had a challenging impact on BBK's consumer loans business. Loans are now restricted to a maximum repayment capacity of 50 per cent of a borrower's income, and to a maximum repayment period of seven years. To improve the credit quality of client loans, BBK reviewed its remedial management policies, resulting in a shift of focus to employers rather than employees, and the introduction of a new collection system to improve the recovery of delinquent accounts at an early stage.

Through its wholly-owned subsidiary, CrediMax, BBK continued to uphold its leading position in the cards services sector in Bahrain, despite increased competition from new and existing players. CrediMax successfully continued to build its image as the preferred brand in Bahrain, maintaining its leadership position in both card issuing and acquiring activities. Developments during 2005 included the launch of an exclusive new credit card in conjunction with Japan Card Bureau (JCB), and the establishment of a third party processing company – Global Payment Services – in partnership with Hightech Payment Systems, a leading technology provider.

During 2005, BBK continued to play a leading role in the **corporate banking** sector. A key achievement was the Bank's successful role as joint issue manager for a BD 10 million five-year floating rate bond for Bahrain Commercial Facilities Company. BBK also provided financing for major infrastructural and industrial projects in the Kingdom. These included expansion of the Hidd power complex and construction of the Pearl Island and Abraj Al Lulu commercial and residential developments. In addition, following liberalisation of the Government of Bahrain's banking arrangements, BBK was mandated by the Ministry of Finance to handle the Ministry of Electricity & Water account.

In the **international banking** arena, BBK maintained its focus on boosting fee-based income and seeking additional trade finance business. The Bank increased its client base during 2005 and remained particularly active in Iran, Egypt, Turkey, and India. BBK also explored potential opportunities in Kazakhstan, following its newfound status as an investment graded country. Additionally, during the year, BBK mandated Citibank and HSBC to handle its debut US$ 1 billion Euro Medium Term Deposit Note (EMTDN), with the initial tranche expected to be launched during the first quarter of 2006.

Management Review continued

Strong and stable revenues from BBK's **treasury and investment** activities continued to underpin the Bank's core earnings in 2005. In view of changing market conditions, characterised by higher interest rates and lower credit spreads, BBK reviewed its money market, capital market and investment activities, and refined its processes for managing liquidity risk and maintaining alternative sources of funding. The Bank also continued to identify alternative investment vehicles through which to meet the more sophisticated requirements of its clients.

BBK services the needs of its **overseas** clients through its branch in Kuwait and representative office in Dubai, and its branch network in India. In 2005, the **Kuwait** branch achieved excellent results, both in terms of profitability and control of expenses. As well as forming important new corporate relationships, the Branch substantially grew its retail business, with innovative marketing activities resulting in the growth of the retail loan portfolio by 120 per cent. The **Dubai** Representative Office enjoyed another successful year, posting record financial results with an increase in profitability of 103 per cent. It also increased its activities in project finance, aircraft leasing, industrial, telecommunications and tourism sector developments, and trade finance transactions. In **India**, BBK achieved a healthy reduction in the non-performing loans portfolio, and also increased the Bank's deposit base and fee-based income. Other developments include enhanced services for NRIs in the GCC region, and the provision of Real Time Gross Settlement (RTGS) remittance facilities across the country.

However, the continued upturn of the Indian economy during 2005 placed greater challenges on BBK's ability to keep pace with the rapid changes in the marketplace and remain competitive with just a two-branch operation. During the year, therefore, the Bank reviewed a number of alternative options for expanding its operations. The option to increase the branch network proved to be time consuming and expensive, while the option to buy into an existing operation was hampered by local regulations that only allow five per cent ownership by foreign investors. As a result, BBK decided it would be best to explore alternative options, the most likely of which will be to disinvest its operations in India.

Internal processes

The value added contribution of **financial control and planning** to BBK's business performance was enhanced during 2005 by a number of new initiatives. These include the continued refinement of Funds Transfer Pricing (FTP) which helps to determine the actual profitability of each business unit, and Risk-Adjusted Return on Capital (RAROC) which is a sophisticated tool for measuring the profitability of clients against associated risk exposures. Also during the year, BBK introduced a new Fixed Assets system and continued to streamline its processes to improve the timeliness and accuracy of reporting, and ensure compliance with BMA regulations.

Enhancing the effectiveness of BBK's banking **operations** is a key element in establishing cost efficiencies and improving client service. Throughout 2005, the focus was maintained on revamping policies, processes and procedures, and re-aligning critical workflow activities. The application of Straight Through Processing (STP) was also completed for inward remittances, standing orders, and payroll processing for corporate clients. Additionally, the latest release of the Treasury back office system was implemented, as well as refinements to the automated Trade Finance system, to enable greater client interaction. The business continuity plan was exhaustively reviewed, with testing of all critical activities and the introduction of revised policy guidelines.

Technology

A major achievement in 2005 was the testing of the Bank's new BD 2 million core banking system, to be implemented in early 2006. The new system incorporates specific applications that will provide BBK clients with a more comfortable, convenient and hassle-free banking experience. Additionally, it will enhance key activities such as Treasury and Risk Management, which will significantly improve the Bank's operational effectiveness and competitive edge. It will also improve the quality and timeliness of management reporting, with information now available interactively on-line. Another key development during the year was the installation a new automated Anti-Money Laundering system, which will provide interactive monitoring, analysis and reporting of all suspicious transactions.

Community

Throughout 2005, BBK continued its longstanding contribution to the social well-being of the local community in Bahrain. To date, the Bank has donated in the region of BD 4 million to numerous charitable, medical, educational, scientific, environmental, cultural, sporting and social institutions and organisations. In addition to its financial support, BBK actively encourages its team members to involve themselves in a range of community activities. These are organised by the Staff Social Activities Committee, which initiates events involving the Bank's team members and their families, together with people from local charities.

The numerous and varied achievements during the year serve to illustrate the evolution of BBK from a 'financial' to a 'people' institution. Our success in 2005 was due, in no small part, to the hard work and cooperation of all BBK team members without exception. It is our culture – how we do things at BBK – that makes us different and which will ensure future growth and prosperity for all our stakeholders.

Dr Farid Ahmed Al Mulla
General Manager Chief Executive Officer

Executive Management

Dr Farid Ahmed Al Mulla

Ahmed Al Banna

Jamal Mohammed Hijres

Abdul Hussain Bustani

Abdulla Abdulrahman Hussain

Abdul Karim Ahmed Bucheery

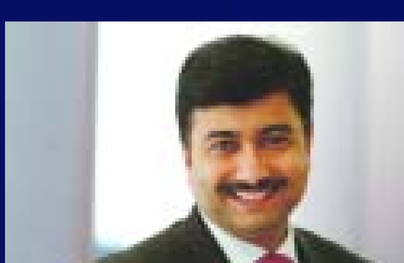
Abdul Rasool Turki

Reyadh Yousif Sater

Amit Kumar

Adnan A. Wahab Al Arayyed

Mahmood Abdul Aziz



Vinit Kohli

Financial Review

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

Operating results

The Bank has shown a strong operating performance for the year ended 31 December 2005. The net operating profit for the year at BD 29.3 million was 14 per cent or BD 3.6 million higher compared to 2004. If the extraordinary income of BD 2.9 million from sale of a strategic investment in the previous year was excluded for the purpose of comparison, the core net profit for the current year increased sharply by BD 6.5 million or 29 per cent as compared to last year. Improvement in performance, which was across almost all the core business activities, contributed to the strong revenue growth while the growth in operating costs has been restricted to 2.36 per cent. The return on average equity has increased from 17.80 per cent to 18.15 per cent in 2005.

Operating income

Total operating income for the year rose to BD 55.9 million, up from BD 50.3 million in the year 2004 (adjusted for extraordinary income of BD 2.9 million), representing an increase of 11.18 per cent. The increase in income is mainly on account of higher net interest income and higher foreign exchange income.

Net interest income

The net interest income for the year grew sharply from BD 29.5 million to BD 35.7 million, an increase of 21 per cent. This reflects a strong underlying growth in the Bank's core business activities. The average loans and investment portfolios grew by 9.6 per cent and 18.7 per cent respectively over the previous year. The net interest margin improved to 2.48 per cent compared to 2.29 per cent in 2004, despite the Bank's prudent policies on credit and liquidity risk.

Other income

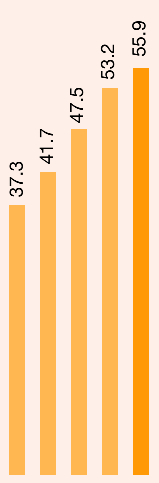
Other operating income includes non interest income which is earned from business activities such as dealing in foreign currencies, investment in funds, the sale of corporate banking and retail banking services, and share of profit in associated companies. Fees and commissions earned were higher than the previous year, mainly due to higher income from the Bank's credit card business, commercial services fees, and corporate and retail banking fees. Loan fees were lower due to the impact of regulatory restriction on the growth of retail loans.

Operating expenses

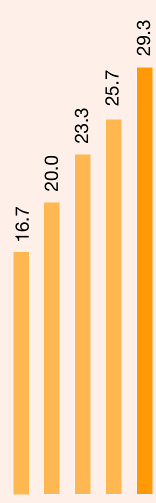
Total operating expenses, which include staff, premises, equipment, depreciation and other administrative costs, increased marginally by BD 0.55 million (2.36 per cent) reflecting the Bank's success in containing costs. As a result, the cost-to-income ratio improved further to 42.6 per cent, as compared to 43.7 per cent in 2004.

Summary income statement

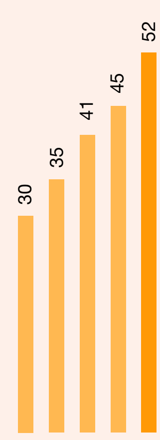
			Variance	Change
BD millions	2005	2004	BD millions	Percent
Net interest income	35.7	29.5	6.2	20.95%
Other income	20.2	23.7	-3.5	-14.73%
Total income	55.9	53.2	2.7	5.07%
Operating expenses	23.8	23.2	0.5	2.36%
Provisions	2.4	4.3	-1.9	-44.64%
Profit before taxation	29.7	25.7	4.1	15.79%
Taxation	-0.5	0.0	-0.5	-
Net profit for the year	29.3	25.7	3.6	14.03%



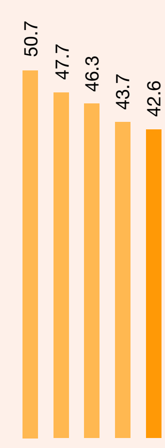
Total income
BD millions



Net profit
BD millions



Earnings per share
Fils



Cost / Income
Per cent

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 the 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 values 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 2.4 million, compared with BD 4.3 million last year, a reduction of 44 per cent. This success in containing net provision change was a result of the Bank's strong focus on proactive remedial management and credit risk management.

Financial position

The year end balance sheet size of the Bank grew from BD 1.42 billion to almost BD 1.50 billion, reflecting an increase of 5.5 per cent. However, the average balance sheet for the year at BD 1.53 billion was 7.5 per cent higher than the corresponding figure for the last year. As at year end, over 11 per cent of the balance sheet was funded by equity with the rest coming from customers, medium term deposits and inter-bank deposits.

Assets

The year end loans and advances to customers at BD 795 million were 4 per cent higher than the previous year. However, the average portfolio of loans at BD 790 million was almost 10 per cent higher than the average for the year 2004. This increase came from growth in corporate lending, mainly in Bahrain.

The investment portfolio of the Bank is classified into three categories, namely, "Held for Trading", "Available for Sale" and "Investments Stated at Amortised Cost". They consist of quoted bonds, equities and unquoted securities that are mainly acquired with the intention of being retained for the long term. At the end of 2005, 32.73 per cent of these investments were in the form of quoted bonds and equities (34.7 per cent at the end of 2004).

Summary balance sheet

BD millions	2005	2004	Variance BD millions	Change Percent
Assets				
Cash and balances with central banks	49.7	35.7	14.0	39.25%
Treasury bills	23.8	25.4	-1.6	-6.40%
Deposits and due from banks and other financial institutions	130.7	187.2	-56.4	-30.16%
Loans and advances to clients	795.0	764.7	30.3	3.96%
Non-trading investment securities	457.5	376.2	81.3	21.61%
Investment in associated companies	9.3	5.8	3.5	59.53%
Interest receivable and other assets	16.0	11.3	4.7	41.77%
Premises and equipment	16.8	14.6	2.2	15.22%
Total Assets	**1,498.8**	**1,420.8**	**77.9**	**5.49%**
Liabilities and Equity				
Liabilities				
Deposits and due to banks and other financial institutions	238.2	228.9	9.4	4.10%
Borrowings under repurchase agreements	102.0	72.2	29.8	41.33%
Medium term deposits from banks	94.3	94.3	0.0	0.00%
Clients' current, savings and other deposits	863.4	844.5	18.9	2.24%
Interest payable and other liabilities	27.5	23.2	4.3	18.40%
Total Liabilities	1,325.4	1,263.0	62.4	4.94%
Equity attributable to shareholders of the parent	173.1	157.8	15.2	9.66%
Minority Interest	0.3	0.0	0.3	-
Total equity (before appropriations)	173.4	157.8	15.6	9.87%
Total Liabilities and Equity	1,498.8	1,420.8	78.0	5.49%

The non-trading investment securities grew sharply by over 21 per cent, mainly on account of growth in investment in quoted bonds, government bonds and other bonds. Investment in associated companies represents the Bank's 20.25 per cent interest in the equity of Bahrain Commercial Facilities Company, a public shareholding company, and the Bank's investment in Sakana Holistic Housing Solutions B.S.C.(c), a newly incorporated jointly controlled company in the Kingdom of Bahrain. The carrying value of this investment represents the Bank's share in the total shareholders' equity of the companies.

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

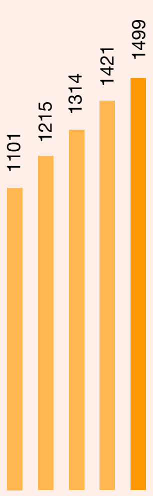
Liabilities

Current, saving and other deposits include balance 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. As at year end, customer deposits increased marginally to BD 863.4 million, compared to BD 844.5 million at the end of 2004. However, average customer deposits, including financial institution customer deposits, grew sharply to BD 980 million for the year, an increase of 14.5 per cent over last year.

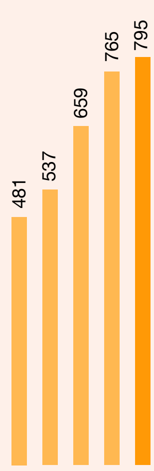
During the year, the Bank maintained BD 94.3 million of medium term deposits from banks with the objective of diversifying sources of funds and continually improving the maturity structure of the Bank's balance sheet. Interest payable and other liabilities consist of accrued interest payable on interest bearing deposits, accrued expenses and provisions for contingent liabilities.

Capital adequacy

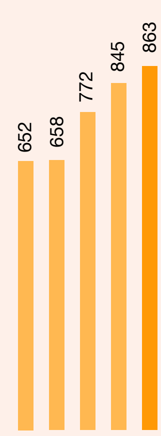
Equity before appropriations, increased to BD 173.1 million at the end of 2005 from BD 157.8 million at the end of the previous year, thus further strengthening the financial position of the Bank. As a result, the Bank's capital adequacy ratio at the end of 2005 rose further to 19.57 per cent which is well above the 8 per cent minimum required by the Basel Accord. This ratio measures total qualifying capital held by a bank in relation to its risk weighted assets and contingents. The Bahrain Monetary Agency increased this minimum requirement to 12 per cent with effect from 1998 for locally incorporated banks.



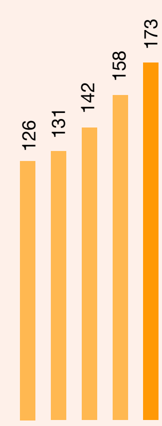
Total assets
BD millions



Loans and advances
BD millions



Cutomer deposits
BD millions



Equity
BD millions

Risk Management

The 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.

In common with other financial institutions, the Bank faces a range of risks in its business and operations These comprise credit risk, market risk (including interest rate risk, currency risk and equity price risk), liquidity risk, and legal and operational risk, and are defined in more detail below.

The Board of Directors of the Bank has overall responsibility for managing the risks. The Board approves and periodically reviews risk management policies and strategies of the Bank. The Management establishes procedures to implement these policies and strategies. The Risk Management Committee (RMC) and Asset and Liability Management Committee (ALMC) comprising Executive and Senior Management, are responsible for overall management of the balance sheet and risk profile of the Bank. RMC discusses important risk-related issues, policies, and procedures, and reviews implementation of its decisions. ALMC reviews issues relating to the balance sheet at a micro level.

The Risk Management Department (RMD) is responsible for identifying credit risk characteristics inherent in new and existing products, activities, countries, regions and industries. In addition, it is responsible for establishing or developing relevant credit policies, procedures and exposure limits to mitigate such risks. The RMD also sets up systems and processes for monitoring market risk and operational risk.

The Credit Management Department (CMD) processes credit applications and ensures that the provisions of credit policies are complied with. The CMD generates regular reports on credit risk exposures, credit rating reviews, credit limits and monitoring systems. Heads of RMD and CMD report directly to the General Manager Chief Executive Officer (GM CEO), in order to ensure independence of the risk management process.

Routine internal audits assess whether the policies and procedures are complied with and, if necessary, suggest ways of further improving internal procedures.

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 maximise 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 creditworthiness 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 by the CMD, which is independent from the Business Units and reports directly to the GM CEO.

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 a comprehensive Risk Management Strategy every year and monitors the progress.

The Credit growth, quality and portfolio composition are monitored continuously to maximise 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 and expired credits, and promptly escalates exceptions, if any, for corrective action.

The Bank has a risk asset rating policy which defines criteria for the rating of risk assets. All credits are assigned a rating in accordance with the defined criteria. All lending relationships are reviewed at least once in a year and more frequently in case of non-performing assets (NPAs). The Internal Audit Department conducts independent reviews of risk assets periodically and submits its report to Executive 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 the Retail, Corporate and International Banking Divisions.

Liquidity risk

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

The Bank has in place a 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 a maturity ladder (time buckets) approach for managing its liquidity. The limits for the 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, undrawn 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. 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.

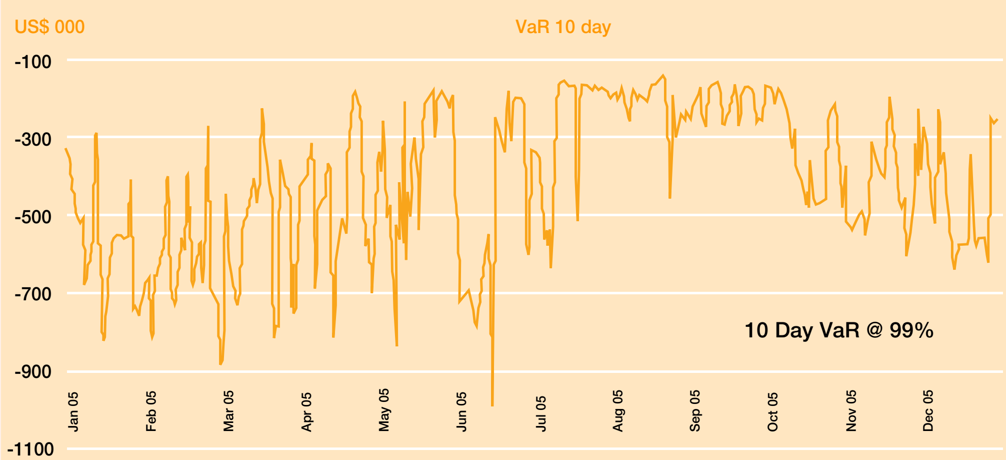
Market risk

Market Risk is defined as the risk of losses in on-balance or off-balance sheet positions of the Bank, which arise 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 to 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 per cent confidence level for a 10-day holding period. This implies 1 per cent possibility of the loss exceeding the VaR amount calculated by the model.

Value at Risk daily movements



As at 31 December 2005, VaR calculated based on the parameters above was BD 91,979 (US$ 243,975). A graph of VaR for the year 2005 is given below. The graph depicts the 10-day horizon VaR movement for each day.

RMD conducts back-testing in accordance with the Market Risk Capital Adequacy Regulations issued by the Bahrain Monetary Agency. Back-testing 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 provide 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 2005. 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. In line with 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

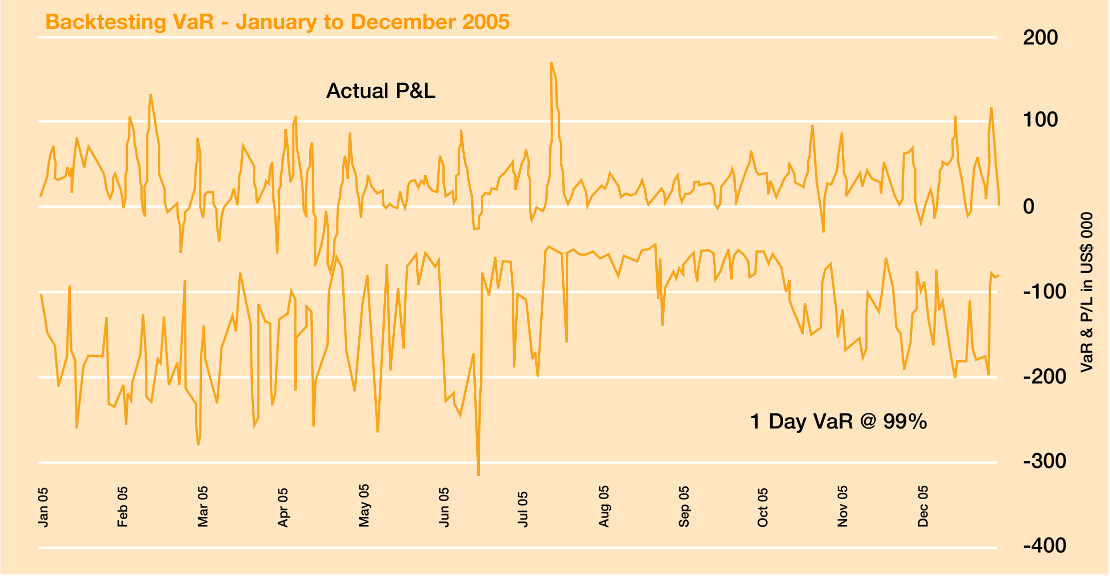
Operational risk is the exposure to loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Bank has clearly defined operations procedures for each of its products and services. The Bank has advanced computer systems which enable it to run operations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

All computer systems and operations procedures are approved by Internal Audit Department. The Internal Audit Department operates independently of other units of the Bank and reports directly to the Audit Committee, which consist of 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 a contingency plan 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 or 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 minimised.

A new Operational risk framework, defining Key Operational Risk Areas, Key Control Standards and Key Risk Indicators, is being devised internally in line with Basel II recommendations.



Corporate Governance and Additional Disclosures

I. BBK philosophy on governance

High standards in corporate governance are fundamental in maintaining BBK's leading position within the local and regional banking sector and the community. Continuous review and adherence to strong corporate governance practices help enhance compliance levels according to international standards and best practice. As the direct responsibility of the Board of Directors, this endeavor 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

a. Role and responsibilities

The principal role of the Board of Directors is to oversee the implementation of the Group's strategic initiatives and its functioning within the agreed framework in accordance with relevant statutory and regulatory structures. The Board ensures the adequacy of financial and operational systems and internal control, as well as the implementation of corporate ethics and code of conduct. The Board has delegated responsibility for overall management of the Bank to the General Manager Chief Executive Officer (GM CEO).

The Board of Directors meets not less than four times a year. Currently it comprises 12 members including the Chairman.

Each Director holds the position for three years, after which he must present himself to the Annual General Meeting for re-appointment. The majority of BBK Directors (including the Chairman and/or Deputy Chairman) are required to attend in order to ensure a quorum.

b. Board committees

	Members	Summary terms of reference
Executive Committee	Mr Yacoub Yousef Al Fulaij Chairman Sh Mohammed bin Isa Al Khalifa Deputy Chairman Mr Jassem Hasan Ali Zainal Mr Aref Saleh Khamis Mr Hamad Ahmed Al Busairi Mr Mohammed Salahuddin	• Six members are appointed for a 1 year term. • Minimum number of meetings required each year: 10 (actual number of meetings in 2005: 12) • Role: reviews, approves and directs the Executive Management on matters raised to the Board of Directors.
Audit Committee	Mr Murad Ali Murad Chairman Mr Abdulla Mohammed Al Sumait Mr Abdul Majeed Haji Al Shatti Mr Jamal Ali Al Hazeem Sh Khalifa bin Daij bin Khalifa Al Khalifa	• Five members are appointed for a 1 year term. • Minimum number of meetings required each year: 4 (actual number of meetings in 2005: 4) • Role: reviews the internal audit programme and internal control systems, considers the major findings of: internal audit review, investigations and management's response, as well as ensuring coordination among internal and external auditors.
Insiders Committee	Mr Murad Ali Murad Chairman Mr Abdulla Mohammed Al Sumait Mr Abdul Majeed Haji Al Shatti Mr Jamal Ali Al Hazeem Sh Khalifa bin Daij bin Khalifa Al Khalifa	• Five members are appointed for a 1 year term. • Minimum number of meetings required each year: 4 (actual number of meetings in 2005: 4) • Role: tracks, monitors and reports trading activities of insiders in accordance with stipulations of the BMA on Insiders.
Compensation Committee	Mr Murad Ali Murad Chairman Mr Jassem Hasan Ali Zainal Mr Hamad Ahmed Al Busairi Mr Aref Saleh Khamis	• Four members are appointed for a 1 year term. • Minimum number of meetings required each year: 2 (actual number of meetings in 2005: 5) • Role: establishes a broad compensation and remuneration policy of the Directors and Executive Management.

The Board reserves the right to form temporary committees and discontinue them, from time to time and as it sees necessary.

c. Board meetings and attendances

During 2005 nine Board meetings were held in Bahrain, on 27 February, 19 June, 16 October and 25 December. The following Directors attended:

27 February	19 June	16 October	25 December
Mr Murad Ali Murad	Mr Murad Ali Murad	Mr Murad Ali Murad	Mr Murad Ali Murad
Mr Jassem Hasan Ali Zainal	Mr Jassem Hasan Ali Zainal	Mr Jassem Hasan Ali Zainal	Mr Jassem Hasan Ali Zainal
Mr Yacoub Yousef Al Fulaij	Mr Mohammed Salahuddin	Mr Yacoub Yousef Al Fulaij	Mr Yacoub Yousef Al Fuaij
Mr Hamad Ahmed Al Busairi	Mr Hamad Ahmed Al Busairi	Mr Mohammed Salahuddin	Mr Hamad Ahmed Al Busairi
Mr Abdulla Mohammed Al Sumait	Sh Mohammed bin Isa Al Khalifa	Mr Abdulla Mohammed Al Sumait	Sh Mohammed bin Isa Al Khalifa
Sh Mohammed bin Isa Al Khalifa	Mr Aref Saleh Khamis	Mr Hamad Ahmed Al Busairi	Mr Aref Saleh Khamis
Mr Aref Saleh Khamis	Mr Abdul Majeed Haji Al Shatti	Sh Mohammed bin Isa Al Khalifa	Mr Abdul Majeed Haji Al Shatti
Mr Abdul Majeed Haji Al Shatti	Mr Jamal Ali Al Hazeem	Mr Aref Saleh Khamis	Mr Jamal Ali Al Hazeem
Mr Jamal Ali Al Hazeem	Mr Ali Hassan Meshari Al Bader	Mr Abdul Majeed Haji Al Shatti	Mr Ali Hassan Meshari Al Bader
Mr Ali Hassan Meshari Al Bader		Mr Jamal Ali Al Hazeem	Sh Khalifa bin Daij bin Khalifa Al Khalifa
		Mr Ali Hassan Meshari Al Bader	
		Sh Khalifa bin Daij bin Khalifa Al Khalifa	

d. Annual General Meeting

The Annual General Meeting of the shareholders was held on 27 February 2005 and another Ordinary meeting of the AGM was held on 16 July 2005.

e. Directors' remuneration

The Directors' remuneration, allowances and expenses for attendance of Board meetings for 2005 were BD 528,296 (2004: BD 386,030).

f. Directors' profiles

Mr Murad Ali Murad Chairman
Director since 21 March 1999
Director: Bahrain Telecommunications Co. (Batelco); Bahrain Commercial Facilities Co.; Bahrain Kuwait Insurance Co. (BKIC). Deputy Chairman: Housing Bank, Bahrain; Al Banader Hotel Co., Bahrain. Member: Council of Vocational Training in Banking Sector, Bahrain. Chairman: Human Resources Development Fund in Banking Sector, Bahrain.

Mr Jassem Hasan Ali Zainal Deputy Chairman
Director since 22 November 1994
Corporate Secretary & General Manager, Investment, The Gulf Bank, Kuwait; Director: International Fund Managers Ltd; Al Madina Investment Co.; Al Razi Holding Co.

Mr Yacoub Yousef Al Fulaij
Director since 28 March 1994
Director: National Bank of Kuwait.

Mr Mohammed Salahuddin
Director since 1 May 1990
Chairman: Mohammed Salahuddin Consulting Engineering Bureau, Bahrain. Director: Bahrain Water Bottling and Beverages Co.; Sunni Waqf Directorate, Bahrain; Bahrain Businessmen's Association; Intershield W.L.L., Bahrain.

Mr Hamad Ahmed Al Busairi
Director since 11 January 2001
Senior Investment Manager, Kuwait Investment Authority; Director: Kuwait Investment Co.

Mr Abdulla Mohammed Al Sumait
Director since 22 April 2001
Deputy Chief General Manager, Al Ahli Bank of Kuwait. Director: Union of Kuwaiti Banks.

Sh Mohammed bin Isa Al Khalifa
Director since 4 December 2002
Acting Director General, General Organisation for Social Insurance, Bahrain. Chairman: Securities and Investment Co., Bahrain. Director: Bahrain Commercial Facilities Co.; National Motor Co., Bahrain; Bahrain Telecommunications Co. (Batelco); Bahrain International Golf Course Co.

Mr Aref Saleh Khamis
Director since 1 April 2003
Asst. Undersecretary for Financial Affairs, Ministry of Finance, Bahrain. Director: Gulf Aluminium Rolling Mills Co. (GARMCO), Bahrain; Arab Ship Building & Repair Yard (ASRY), Bahrain; Bahrain Petroleum Co. (Bapco); Sh Mohd bin Khalifa bin Salman Al Khalifa Cardiac Centre, Bahrain. Member: Supreme Council of Traffic, Bahrain; Zakat Fund, Ministry of Islamic Affairs, Bahrain.

Mr Jamal Ali Al Hazeem
Director since 27 February 2005
Vice Chairman: CreditOne Co., Kuwait. Director: DoCar Co., Turkey; Nass Group, Bahrain; Al Tameer Co, Kuwait.

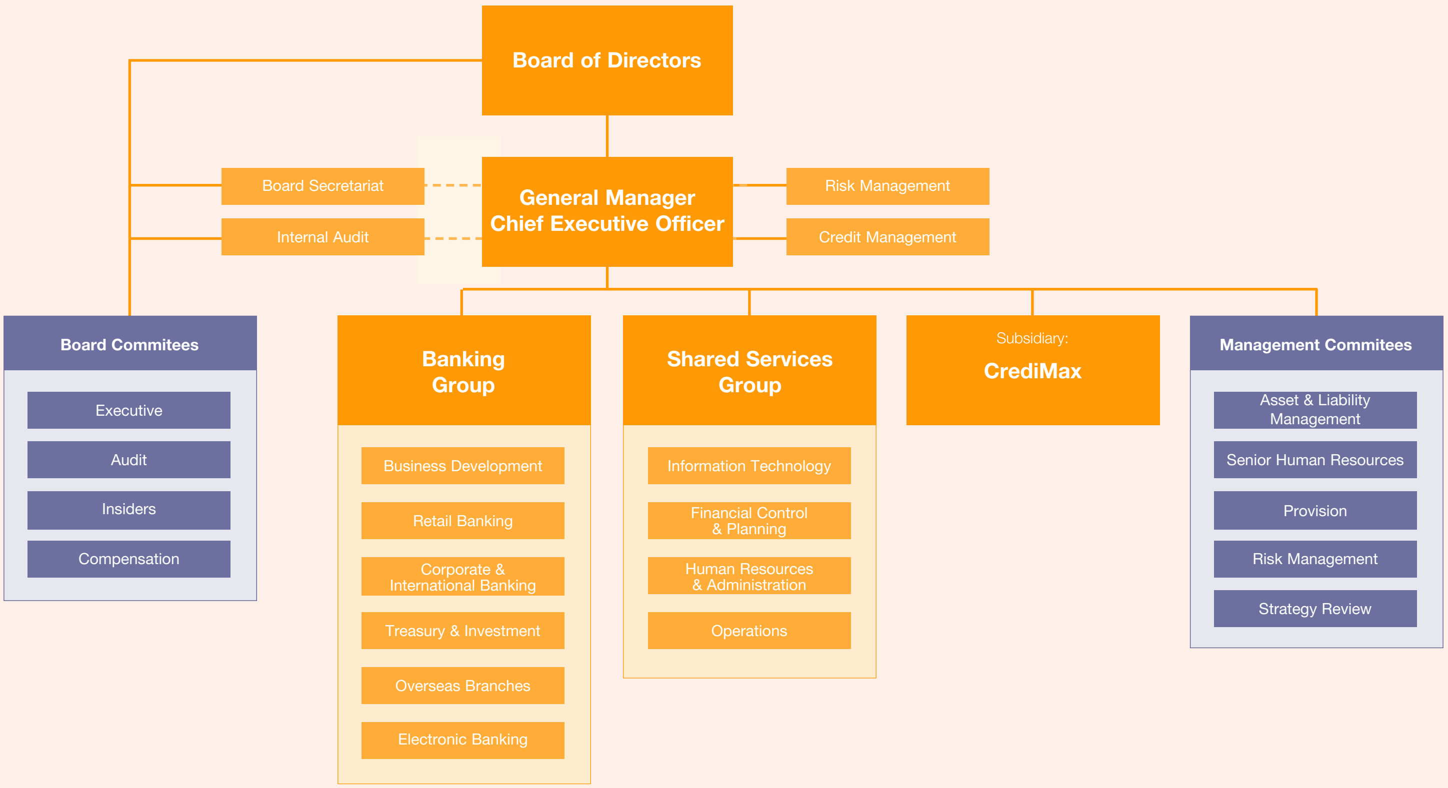
Mr Abdul Majeed Haji Al Shatti
Director since 24 March 2004
Chairman & Managing Director, Commercial Bank of Kuwait.

Mr Ali Hassan Meshari Al Bader
Director since 27 February 2005
Chairman, Strategia Investment Company, Kuwait.

Sh Khalifa bin Daij bin Khalifa Al Khalifa
Director since 27 February 2005
President, Court of the Crown Prince, Bahrain. Director: Bahrain International Circuit.

Board Secretary: Saad Mohammed Al Hooti

III. Organisational structure



IV.Executive management

a. Leadership

The BBK Executive Management is under the leadership of the GM CEO, who reports to the Board of Directors.

b. Executive management committees

All BBK Executive Management Committees are chaired by the GM CEO. Meetings of each committee take place once every month and are attended by Committee members, who are heads of relevant business and support units within the Bank:

Committee	Summary terms of reference
Asset & Liability Management	• Establishes policies and guidelines for the overall management of the balance sheet and its associated risks.
Senior Human Resources	• Establishes appropriate policies, procedures and guidelines for the management of human resources.
Provision	• Reviews and establishes provisioning requirements for loans, advances and investments.
Risk Management	• Identifies, measures, monitors and controls risk by establishing risk policies and procedures.
Strategy Review	• Reviews and monitors progress on strategic initiatives.

c. Executive management profiles

Dr Farid Ahmed Al Mulla
General Manager Chief Executive Officer
Education: PhD in Economics and International Relations – University of Sussex, UK (1982).
Experience: 23 years' banking experience.
Date of joining BBK: 1990.

Mr Ahmed Al Banna
Deputy General Manager, Banking Group
Education: BSc – University of Houston, USA (1978).
Experience: 22 years' banking experience.
Date of joining BBK: 1987.

Mr Jamal Mohammed Hijris
Assistant General Manager, Retail Banking
Education: MBA – University of Bahrain, Bahrain (1991).
Experience: 27 years' banking experience.
Date of joining BBK: 1978.

Mr Abdul Hussain Bustani
Assistant General Manager, Human Resources and Administration
Education: Higher National Diploma (Civil Engineering) – Trent University, UK (1978).
Experience: 18 years' banking experience.
Date of joining BBK: 1988.

Mr Abdulla Abdulrahman Hussain
Assistant General Manager, Information Technology
Education: MBA – University of Bahrain, Bahrain (1994).
Experience: 18 years' IT experience.
Date of joining BBK: 2002.

Mr Abdul Karim Ahmed Bucheery
Assistant General Manager, Corporate and International Banking
Education: BSc – University of Aleppo, Syria (1976).
Experience: 28 years' banking experience.
Date of joining BBK: 2001.

Mr Abdul Rasool Turki
Assistant General Manager, Treasury and Investment
Education: Diploma – People's College, UK (1977).
Experience: 27 years' banking experience.
Date of joining BBK: 2004.

Mr Reyadh Yousif Sater
Senior Manager, Internal Audit
Education: MBA – University of Glamorgan, UK (2001).
Experience: 28 years' banking experience.
Date of joining BBK: 1977.

Mr Amit Kumar
Senior Manager, Risk Management
Education: MBA – India Institute of Management, India (1983).
Experience: 22 years' banking experience.
Date of joining BBK: 1994.

Mr Adnan A. Wahab Al Arrayed
Senior Manager, Credit Management
Education: BSc – Beirut Arab University, Lebanon (1984).
Experience: 24 years' banking experience.
Date of joining BBK: 1981

Mr Vinit Kohli
Chief Financial Officer, Financial Control and Planning
Education: BCom – Delhi University, India; CA – Institute of Chartered Accountants of India (1983).
Experience: 24 years' experience.
Date of joining BBK: 2002.

Mr Mahmood Abdul Aziz
Senior Manager, Operations
Education: Executive Management Diploma – University of Bahrain, Bahrain. Gulf Executive Management Program – University of Virginia.
Experience: 34 years' banking experience,.
Date of joining BBK: 1976.

V. Shareholders' information

BBK's shares are listed on the Bahrain Stock Exchange. The Bank has issued 569,062,500 equity shares of face value (100 fils). All shares are fully paid.

a. Shareholders (as of 31 December 2005)

Name	Nationality	No. of shares	% holding
Bahrain Citizens and Others	-	113,561,687	19.97
Pension Fund Commission	Bahraini	107,224,048	18.84
General Organization for Social Insurance (GOSI)	Bahraini	76,212,593	13.39
Bank of Kuwait and the Middle East (BKME)	Kuwaiti	38,411,711	6.75
Commercial Bank of Kuwait (CBK)	Kuwaiti	38,411,711	6.75
Al Ahli Bank of Kuwait	Kuwaiti	38,411,711	6.75
Kuwait Finance Investment Co.	Kuwaiti	36,268,511	6.37
Kuwait Investment Projects Co.	Kuwaiti	29,499,620	5.18
Kuwait Investment Authority	Kuwaiti	21,339,836	3.75
Kuwait Investment Company (KIC)	Kuwaiti	21,339,836	3.75
Pearl of Kuwait Real Estate Co.	Kuwaiti	18,500,000	3.25
United National Holding Co.	Kuwaiti	18,500,000	3.25
Kuwait International Investment Co.	Kuwaiti	11,381,236	2.00

b. Distribution schedule of each class of equity (as of 31 December 2005)

Category	No. of shares	No. of shareholders	% of outstanding shares
Less than 1%	113,561,687	2,396	19.97
1% to less than 5%	91,060,908	5	16.00
5% to less than 10%	181,003,264	5	31.80
10% to less than 20%	183,436,641	2	32.23
20% to less than 50%	–	–	–
50% and above	–	–	–

c. Directors' interests

The number of shares held by the directors and their related parties as at (as of 31 December 2005):

Director	Type of shares	31st Dec 2004	31st Dec 2005
Murad Ali Murad	Ordinary	238.000	238,000
Mohammed Salahuddin	Ordinary	204,655	204,655
Jassem Hasan Ali Zainal	Ordinary	None	100,000
Abdulla Mohammed Al Sumait	Ordinary	None	100,000
Ali Hassan Meshari Al Bader	Ordinary	None	100,000

Related parties: Al Janabeya Co. WLL owns 15,000 shares.

d. Material contracts involving Directors

Provision of consultancy services by Mohammed Salahuddin Consultancy Engineering Bureau (MSECB) for the Financial Malls' project.
Contract value: BD 68,770 (as at 31 December 2005).

VI. Other shareholdings

Company	% holding
Sakana Holistic Housing Solutions	50.00%
Bahrain Commercial Facilities Company	20.25%
Securities and Investment Company (SICO)	8.00%
Bahrain Kuwait Insurance Company (BKIC)	6.83%
Bahrain Telecommunications Company (Batelco)	2.40%

VII. Compliance and anti-money laundering

Compliance with regulatory and statutory requirements is an ongoing process. The Bank is conscious of its responsibilities in observing all regulatory provisions and best international practices in its functioning. The Bank has an established Compliance Unit in keeping with Basel and BMA guidelines and it acts as a focal point for regulatory compliance and other best practice compliance principles. Anti-money laundering measures form an important area of the function, in addition to areas of corporate governance, disclosure standards, adherence to best practices, and conflict of interest. The Bank has documented an Anti-Money Laundering and Combating Terrorist Financing Policy and Procedure, which contains sound Customer Due Diligence measures, procedures for identifying and reporting suspicious transactions, and a programme for periodic awareness training to staff, record keeping, and a designated Money Laundering Reporting Officer. The Bank has also taken all other initiatives in keeping with comprehensive Anti-Money Laundering Regulations of Bahrain Monetary Agency. The Bank's anti-money laundering measures are audited by independent external auditors every year, and their report is submitted to the BMA. The overseas branches in India and Kuwait and subsidiary (Credimax) have designated compliance and MLRO functions to ensure implementation of local regulations, and also to meet BMA requirements as applicable.

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 BMA. These regulations and guidelines are consistent with the revised FATF 49 recommendations, 'Customer Due Diligence for Banks' paper, and best international practices.

VIII. Code of conduct

The Board has approved a code of conduct for the Directors, Executive Management and members of staff of the Bank. The code binds signatories to the highest standard of professionalism and due diligence in discharging their duties. The code outlines areas of conflict of interest, confidentiality and responsibilities of signatories to adhere to best practices.

IX. Insiders trading

The Bank has established Insiders Trading Procedures to ensure that insiders are aware of the legal and administrative requirements regarding holding and trading in the Bank's securities with the primary objective of preventing abuse of inside information. Insiders are defined to include the Directors, management, staff and any person or firm connected to these individuals.

X. Stock incentive scheme

As a part of its compensation policy, the Bank has an Employee Share Option Scheme, under which certain categories of employees are notionally allotted a specified number of shares, at a grant price, and with a defined resting period. On completion of the resting period, the employee can exercise the option within the purview of the Insiders guidelines

XI. Communication strategy

The Bank has an open policy on communication with its stakeholders. Shareholders are invited by the Chairman to attend the Annual General Meeting. The Chairman and other Directors attend the AGM and are available to answer any questions. The Bank is at all times mindful and conscious of its regulatory and statutory obligations regarding dissemination of information to its stakeholders. The Bank provides information on all events that merit announcement, either on its website – www.bbkonline.com – or through newspapers. The Bank's 3-year financials are also posted on the website as well as in annual reports. The Bank uses a bulletin board for communicating with its staff on general matters, and sharing information of common interest and concern.

XII. Offices, international branches and subsidiaries

a. Offices and international branches

BBK Headquarters
43 Government Avenue.
PO Box 597, Manama, Kingdom of Bahrain.
Tel: +973 17 22 33 88
Fax: +973 17 22 98 22
Cable: BAHKUBANK. Telex: 8919. SWIFT: BBKUBHBM

BBK Kuwait
Ahmed Al Jaber Avenue.
PO Box 24396, 13104 Safat, State of Kuwait.
Tel: +965 241 7140
Fax: +965 244 0937

BBK Dubai Representative Office
Creek Tower, Office No. 18A.
PO Box 31115, Dubai, United Arab Emirates.
Tel: +9714 221 0560 / 221 0570 / 223 7156
Fax: +9714 221 0260

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

BBK Hyderabad
6-3-550 LB Bhavan, Somajiguda, Hyderabad 500482, India.
Tel: +9140 339 8219
Fax: +9140 337 5977

b. Subsidiaries

Credimax
Hidaya 1 Building, 49 Government Avenue,
PO Box 5350, Manama, Kingdom of Bahrain.
Tel: +973 17 207 207
Fax: +973 17 214 193

Auditors’ Report to the Shareholders

We have audited the accompanying consolidated balance sheet of BBK B.S.C. (previously Bank of Bahrain and Kuwait B.S.C.) (the Bank) and its subsidiaries (the Group) as of 31 December 2005, 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 2005, 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 2005 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

29 January 2006
Manama, Kingdom of Bahrain

Consolidated Financial Statements

Consolidated Balance Sheet

31 December 2005

	Notes	2005 BD '000	2004 (Restated) BD '000
ASSETS			
Cash and balances with central banks	4	**49,686**	35,682
Treasury bills	5	**23,806**	25,435
Trading investments		**10**	2
Deposits and due from banks and other financial institutions		**130,713**	187,153
Loans and advances to customers	6	**795,006**	764,689
Non-trading investment securities	7	**457,476**	376,175
Investment in associated companies	8	**9,272**	5,812
Interest receivable and other assets	9	**16,009**	11,292
Premises and equipment	10	**16,799**	14,580
TOTAL ASSETS		**1,498,777**	1,420,820
LIABILITIES AND EQUITY			
LIABILITIES			
Deposits and due to banks and other financial institutions		**238,242**	228,852
Borrowings under repurchase agreements	11	**102,003**	72,176
Medium term deposits from banks	12	**94,250**	94,250
Customers' current, savings and other deposits		**863,400**	844,502
Interest payable and other liabilities	13	**27,489**	23,217
TOTAL LIABILITIES		**1,325,384**	1,262,997
EQUITY			
Share capital	14	**56,906**	56,906
Treasury stock	14	**(1,357)**	(1,053)
Statutory reserve	15	**26,507**	23,574
General reserve	15	**20,000**	20,000
Cumulative changes in fair values	16	**29,650**	22,926
Foreign currency translation adjustments		**(391)**	(508)
Retained earnings		**13,899**	15,354
Proposed appropriations	17	**27,850**	20,624
EQUITY ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**173,064**	157,823
Minority Interest		**329**	-
TOTAL EQUITY		**173,393**	157,823
TOTAL LIABILITIES AND EQUITY		**1,498,777**	1,420,820

The consolidated financial statements were authorised for issue in accordance with a resolution of the directors on 29 January 2006.

Murad Ali Murad
Chairman

Jassem Hasan Ali Zainal
Deputy Chairman

Dr Farid Ahmed Al Mulla
General Manager
Chief Executive Officer

The attached notes 1 to 39 form part of these consolidated financial statements.

Consolidated Income Statement

Year ended 31 December 2005

	Notes	2005 BD '000	2004 BD '000
Interest income	18	**74,616**	50,784
Interest expense	19	**38,906**	21,259
Net interest income		**35,710**	29,525
Share of profit in associated companies	8	**1,571**	1,251
Other income	20	**18,605**	22,411
		55,886	53,187
Staff costs		**13,347**	13,329
Other expenses		**8,415**	7,753
Depreciation		**2,030**	2,162
Net provision for impairment on loans and advances to customers	6	**2,449**	2,444
Net (write back) provision for impairment of non-trading investment securities	7	(88)	1,821
Total operating expenses		**26,153**	27,509
PROFIT BEFORE TAXATION		**29,733**	25,678
Taxation - foreign units		(**453**)	-
NET PROFIT FOR THE YEAR		**29,280**	25,678
Attributable to:			
SHAREHOLDERS OF THE PARENT		**29,328**	25,678
Loss attributable to minority interests		(**48**)	-
		29,280	25,678
BASIC EARNINGS PER SHARE (BD)	21	**0.052**	0.045

The attached notes 1 to 39 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

Year ended 31 December 2005

	2005 BD '000	2004 BD '000
OPERATING ACTIVITIES		
Profit for the year before taxation	**29,733**	25,678
Adjustments for:		
Net provisions (write backs) relating to:		
Loans and advances to customers	**2,449**	2,444
Non-trading investment securities	(**88**)	1,821
Share of profit in associated companies (Note 8)	(**1,571**)	(1,251)
Depreciation	**2,030**	2,162
Realised (gains) on sale of investments	(**1,699**)	(6,013)
Taxation - foreign units	(**453**)	-
Operating profit before working capital changes	**30,401**	24,841
(Increase) decrease in operating assets:		
Mandatory reserve deposits with central banks	(**4,456**)	(261)
Treasury bills maturing after 91 days	**5,503**	34,002
Trading investments	(**8**)	4,452
Deposits and due from banks and other financial institutions	**10,158**	10,167
Loans and advances to customers	(**32,766**)	(107,966)
Interest receivable and other assets	(**3,948**)	2,636
Increase (decrease) in operating liabilities:		
Deposits and due to banks and other financial institutions	**9,390**	(59,008)
Borrowings under repurchase agreements	**29,827**	68,699
Customers' current, savings and other deposits	**18,898**	72,327
Interest payable and other liabilities	**4,272**	188
Net cash from operating activities	**67,271**	50,077
INVESTING ACTIVITIES		
Purchase of non-trading investment securities	(**375,210**)	(493,244)
Disposal and maturities of non-trading investment securities	**301,452**	460,894
Dividends received from associated company (Note 8)	**810**	709
Investment in associated company (Note 8)	(**2,500**)	-
Purchase of premises and equipment	(**4,249**)	(1,371)
Net cash used in investing activities	(**79,697**)	(33,012)
FINANCING ACTIVITIES		
Medium term deposits from banks	-	47,125
Purchase of treasury stock	(**304**)	-
Repayment of medium term loans	-	(37,700)
Minority interest in share capital of subsidiary	**377**	-
Payment of dividend, directors' remuneration and donations	(**20,624**)	(17,801)
Net cash used in financing activities	(**20,551**)	(8,376)
Foreign currency translation adjustments	**117**	324
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(**32,860**)	9,013
Cash and cash equivalents at beginning of the year	**175,213**	166,200
CASH AND CASH EQUIVALENTS AT END OF THE YEAR (Note 23)	**142,353**	175,213

The attached notes 1 to 39 form part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

Year ended 31 December 2005

		Attributable to shareholders of the parent										
	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	Minority interest BD '000	Total equity BD '000
Balance at 31 December 2003 (as previously stated)		56,906	(1,053)	21,006	20,000	3,986	(832)	24,438	17,801	142,252	-	142,252
Adjustment arising from the application of IAS 39 (revised)		-	-	-	-	11,603	-	(11,570)	-	33	-	33
Balance at 31 December 2003 (restated)		56,906	(1,053)	21,006	20,000	15,589	(832)	12,868	17,801	142,285	-	142,285
Foreign exchange translation adjustments		-	-	-	-	-	324	-	-	324	-	324
Approval of directors' remuneration and donations for 2003		-	-	-	-	-	-	-	(860)	(860)	-	(860)
Net movement in cumulative changes in fair values	16	-	-	-	-	7,337	-	-	-	7,337	-	7,337
Total income and expense for the year recognised directly in equity		-	-	-	-	7,337	324	-	(860)	6,801	-	6,801
Net profit for the year - 2004		-		-	-	-	-	25,678	-	25,678	-	25,678
Total income and expense for the period		-	-	-	-	7,337	324	25,678	(860)	32,479	-	32,479
Approval of dividend for 2003		-	-	-	-	-	-	-	(16,941)	(16,941)	-	(16,941)
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	22,926	(508)	15,354	20,624	157,823	-	157,823

The attached notes 1 to 39 form part of these consolidated financial statements.

Consolidated Statement of Changes in Equity continued

Year ended 31 December 2005

	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	Minority interest BD '000	Total equity BD '000
		Attributable to shareholders of the parent										
Balance at 31 December 2004 (as previously stated)		56,906	(1,053)	23,574	20,000	13,446	(508)	24,789	20,624	157,778	-	157,778
Adjustment arising from the application of IAS 39 (revised)		-	-	-	-	9,480	-	(9,435)	-	45	-	45
Balance at 31 December 2004 (restated)		56,906	(1,053)	23,574	20,000	22,926	(508)	15,354	20,624	157,823	-	157,823
Foreign exchange translation adjustments		-	-	-	-	-	117	-	-	117	-	117
Approval of directors' remuneration and donations for 2004		-	-	-	-	-	-	-	(860)	(860)		(860)
Net movement in cumulative changes in fair values	16	-	-	-	-	6,724	-	-	-	6,724	-	6,724
Total income and expense for the year recognised directly in equity		-	-	-	-	6,724	117	-	(860)	5,981	-	5,981
Net profit for the year – 2005		-	-	-	-	-	-	29,328	-	29,328	(48)	29,280
Total income and expense for the period		-	-	-	-	6,724	117	29,328	(860)	35,309	(48)	35,261
Approval of dividend for 2004		-	-	-	-	-	-	-	(19,764)	(19,764)	-	(19,764)
Purchase of treasury stock		-	(304)	-	-	-	-	-	-	(304)	-	(304)
Minority interest in share capital of subsidiary		-	-	-	-	-	-	-	-	-	377	377
Transfer to statutory reserve		-	-	2,933	-	-	-	(2,933)	-	-	-	-
Proposed directors' remuneration	17	-	-	-	-	-	-	(390)	390	-	-	-
Proposed donations	17	-	-	-	-	-	-	(600)	600	-	-	-
Proposed dividend	17	-	-	-	-	-	-	(19,747)	19,747	-	-	-
Proposed issue of bonus shares		-	-	-	-	-	-	(7,113)	7,113	-	-	-
Balance at 31 December 2005		**56,906**	**(1,357)**	**26,507**	**20,000**	**29,650**	**(391)**	**13,899**	**27,850**	**173,064**	**329**	**173,393**

Month end average equity – 2005	**161,614**
Month end average equity – 2004	144,644

Retained earnings include BD 11,164 thousand (2004: BD 10,501 thousand) of non - distributable reserves.

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

The attached notes 1 to 39 form part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

31 December 2005

1 ACTIVITIES

BBK B.S.C (previously 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. The Group is engaged in commercial banking activities through its branches in Bahrain, Kuwait and India, as well as through its credit card subsidiary CrediMax B.S.C. (c). The Bank's registered office is at 43 Government Avenue, P O Box 597, Manama, Kingdom of Bahrain.

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 their year end. The bank has one 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.

Credimax B.S.C. (c) owns 66.67% of the share capital of Global Payment Services W.L.L., which is engaged in processing and backup services relating to credit cards, debit cards and charge cards.

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 accordance with International Financial Reporting Standards (IFRS) and are in conformity with the Bahrain Commercial Companies Law and the Bahrain Monetary Agency Law.

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. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and are otherwise carried at cost, are adjusted to record changes in fair values attributable to risks that are being hedged.

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

Change in accounting policies

The accounting policies are consistent with those used in the previous year with the exception of the following policies which have been revised due to the adoption of revised version of IAS 32 and 39, becoming mandatory for financial years beginning on or after 1 January 2005.

Investments originated by the Group

Investments in certain debt securities where the Group provided funds directly to the issuer were previously classified as "originated by the Group" and stated at amortised cost, adjusted for effective fair value hedges, less provision for impairment. In accordance with the revised IAS 39 where these are quoted in an active market they have been reclassified, with effect from 1 January 2004, as available for sale investments. The impact of this was to increase the carrying value of such investments now classified as available for sale investments by BD 33 thousand and BD 45 thousand at 1 January 2004 and 1 January 2005, respectively, with a corresponding increase in cumulative changes in fair value.

Transition adjustment

In accordance with the IAS 39, revised, the unrecycled adjustment to retained earnings relating to fair values of available for sale investments, arising on the adoption of IAS 39, has been reclassified from retained earnings to cumulative changes in fair value on 1 January 2003.

Impairment of available for sale investment

Under IAS 39, revised, impairment on equity investments must be recognised when there is either a significant or prolonged decline in fair value. Previously there was no such requirement and impairment was only recognised if it was deemed to be other than temporary. As a result, impairment losses amounting to BD 1,145 thousand have been reclassified from cumulative changes in fair values to retained earnings on 1 January 2003.

3 SIGNIFICANT ACCOUNTING POLICIES continued

Change in accounting policies continued

In the case of available for sale equity investments, reversals of previously recognised impairment losses are no longer recorded through the consolidated income statement but as increases in cumulative changes in fair value. There was no impact on the consolidated income statement for the comparative year ended 31 December 2004 as there were no such reversals.

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

These are stated at cost, adjusted for effective hedges, less 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.

Non-trading investment securities

These are classified as follows:

- Held-to-maturity
- Available-for-sale
- Investments carried at amortised cost

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.

Investments carried at amortised cost

Debt instruments which do not meet the definition of held to maturity and which have fixed or determinable payments but are not quoted in an active market are treated effectively as investments carried at amortised cost, (adjusted for effective hedges) less provision for impairment in value.

Available-for-sale

All other investments are classified as "available for sale". After initial recognition, “available-for-sale” investments are normally remeasured at fair value, unless fair value cannot be reliably measured in which case they are measured at cost less impairment. Fair value changes which are not part of an effective hedging relationship, are reported as a separate component of equity "as cumulative changes in fair value" until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as “cumulative changes in fair value” within equity, is included in the consolidated income statement for the year.

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

3 SIGNIFICANT ACCOUNTING POLICIES continued

Impairment and uncollectability of financial assets continued

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.

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

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

Fair values

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

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

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

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.

Investment in associated company

An associate is a company in which the Group exerts significant influence, normally comprising an interest of 20% - 50% in the voting capital 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 carrying 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 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 are included in other assets and derivatives with negative market values 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 year.

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 consolidated income statement. These embedded derivatives are measured at fair value with the changes in fair value recognised in the consolidated 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.

Where the Group enters into an interest rate swap to change interest from fixed to floating (or vice versa) the amount of interest income or expense is adjusted by the net interest on the swap.

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

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 with original maturity within ninety-one days from the date of acquisition.

Trade date accounting and settlement date accounting

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

Significant accounting judgements and estimates

Judgements

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations, which could have effect in the amounts recognised in the consolidated financial statements:

Classification of investments

Management decides on acquisition of an investment whether it should be classified as held for trading or available for sale or investments carried at amortised cost.

The Group classifies investments as trading if they are acquired primarily for the purpose of making a short term profit by the dealers.

The Group classifies debt instruments as carried at amortised cost if the debt instruments are not quoted in an active market.

All other investments are classified as available for sale.

3 SIGNIFICANT ACCOUNTING POLICIES continued

Estimation assumptions

The key assumptions concerning the future period and the other sources of estimation, which could cause an adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment losses on loans and advances and investments

The Group reviews its problem loans and advances and investments on a quarterly basis to assess whether a provision for impairment should be recorded in the consolidated income statement. In particular, considerable judgement by management is required in the estimation of the amount and timing of future cash flows for determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and the actual results may differ resulting in future changes to such provisions.

Collective impairment provisions on loans and advances

In addition to specific provisions against individually significant loans and advances, the Group also makes a collective impairment provision against groups of loans and advances which have not been identified for allocating specific provision but carry higher risk of default than originally perceived when the assets were booked.

4 CASH AND BALANCES WITH CENTRAL BANKS

	2005 BD '000	2004 BD '000
Cash	**7,885**	6,851
Current account and placements with central banks	**18,080**	9,566
Mandatory reserve deposits with central banks	**23,721**	19,265
	49,686	35,682

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

	2005 BD '000	2004 BD '000
Commercial loans	**541,666**	544,264
Consumer loans	**113,721**	111,954
Overdrafts	**139,448**	118,485
Credit cards	**27,148**	25,937
Other	**22,381**	22,674
	844,364	823,314
Less: Provision for impairment and interest in suspense	**(49,358)**	(58,625)
	795,006	764,689

6 LOANS AND ADVANCES TO CUSTOMERS continued

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

(i) Industry sector

	2005 BD '000	2004 BD '000
Trading and manufacturing	**273,710**	278,871
Banks and other financial institutions	**83,553**	105,133
Construction and real estate	**103,689**	84,307
Government and public sector	**76,553**	79,373
Individuals	**210,714**	200,643
Others	**96,145**	74,987
	844,364	823,314
Less: Provision for impairment and interest in suspense	**(49,358)**	(58,625)
	795,006	764,689

(ii) Geographical region

	2005 BD '000	2004 BD '000
Gulf Co-operation Council countries	**781,502**	740,211
European Union countries	**8,941**	20,327
Asia	**51,558**	60,225
Others	**2,363**	2,551
	844,364	823,314
Less: Provision for impairment and interest in suspense	**(49,358)**	(58,625)
	795,006	764,689

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

	2005				2004
	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	**8,321**	**17,786**	**42,271**	**68,378**	79,292
Less: Provisions				**(35,278)**	(39,960)
Less: Interest in suspense				**(11,691)**	(16,292)
Net outstanding				**21,409**	23,040

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

	2005 BD '000	2004 BD '000
At 1 January	**58,625**	78,892
Charge for the year	**8,909**	7,306
Recoveries/write-backs	**(6,460)**	(4,862)
Interest suspended during the year, net	**1,584**	3,071
Amounts written off during the year, net	**(12,369)**	(24,956)
Interest recognised on impaired loans	**(868)**	(565)
Exchange and other movements	**(63)**	(261)
Balance at 31 December	**49,358**	58,625

6 LOANS AND ADVANCES TO CUSTOMERS continued

d) As of 31 December 2005, gross loans and advances to customers which were classified as impaired amounted to BD 68.4 million (2004: BD 79.3 million). The total of provisions carried and the value of securities held for these loans amounted to BD 100.7 million (2004: BD 92 million).

e) As of 31 December 2005, the balance of restructured loans amounted to BD 8.9 million (2004: BD 16.8 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	Carried at amortised cost BD '000	**Total 2005 BD '000**	Total 2004 BD '000
Quoted investments				
Quoted equities	31,429	-	**31,429**	26,086
Quoted bonds	118,292	-	**118,292**	104,537
Managed funds	10,360	-	**10,360**	9,359
	160,081	-	**160,081**	139,982
Unquoted investments				
Government bonds	-	167,729	**167,729**	120,427
Other bonds	22,741	72,589	**95,330**	78,162
Unquoted equities	14,654		**14,654**	6,702
Managed funds	16,800		**16,800**	25,811
Others	1,503	5,653	**7,156**	9,496
	55,698	245,971	**301,669**	240,598
	215,779	245,971	**461,750**	380,580
Provision for impairment	(3,331)	(943)	(**4,274**)	(4,405)
Balance at 31 December 2005	**212,448**	**245,028**	**457,476**	
Balance at 31 December 2004	196,640	179,535		376,175

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

	Available-for-sale BD '000	Carried at amortised cost BD '000	**Total 2005 BD '000**	Total 2004 BD '000
Balance at 1 January	3,419	986	**4,405**	2,593
Charge for the year	192	235	**427**	2,320
Write back	(237)	(278)	(**515**)	(499)
Exchange and other movements	(43)	-	(**43**)	(9)
Balance at 31 December	3,331	943	**4,274**	4,405

Included under available-for-sale investments are unquoted investments amounting to BD 19.4 million (2004: BD 33.8 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 COMPANIES

The Group has a 20.25% (2004: 20.25%) shareholding in Bahrain Commercial Facilities Company B.S.C. (BCFC), incorporated in the Kingdom of Bahrain. During the year the Group has taken a 50 % stake in Sakana Holistic Housing Solutions B.S.C. (c), a newly incorporated jointly controlled company incorporated in the Kingdom of Bahrain which will be engaged in real estate financing. The following tables illustrate summarised financial information of the Group in these entities:

	2005 BD '000	2004 BD '000
Carrying amount of investment in associates		
At 1 January	**5,812**	5,081
Additional investment in new associate	**2,500**	-
Share of results after tax	**1,571**	1,251
Dividends paid	**(810)**	(709)
Change in unrealised fair values -associated company (Note 16)	**199**	189
At 31 December	**9,272**	5,812
Share of associates balance sheet:		
Current and non current assets	**26,378**	21,516
Current and non current liabilities	**17,106**	15,704
Net assets	**9,272**	5,812
Share of associates revenue and results:		
Revenue	**3,177**	2,639
Results	**1,571**	1,251

The results of BCFC are for the twelve month period ended 30 September being the latest available information.

9 INTEREST RECEIVABLE AND OTHER ASSETS

	2005 BD '000	2004 BD '000
Interest receivable	**8,508**	5,143
Collateral pending sale	**828**	828
Accounts receivable	**1,000**	1,338
Positive fair value of derivatives (Note 25)	**1,254**	1,134
Advance tax	**716**	348
Deferred tax	**-**	421
Prepaid expenses	**638**	497
Other	**3,065**	1,583
	16,009	11,292

10 PREMISES AND EQUIPMENT

	Free hold land BD '000	Lease hold properties and building BD '000	Furniture and equipment BD '000	Capital work in progress BD '000	Total BD '000
Cost	**6,288**	**12,557**	**16,185**	**564**	**35,594**
Accumulated Depreciation	**-**	**6,695**	**12,100**	**-**	**18,795**
Net book value at 31 December 2005	**6,288**	**5,862**	**4,085**	**564**	**16,799**
Net book value at 31 December 2004	4,966	6,225	2,878	511	14,580

The depreciation charge for the year amounted to BD 2 million (2004: BD 2.2 million).

11 BORROWINGS UNDER REPURCHASE AGREEMENTS

The proceeds from assets sold under repurchase agreements, at the year-end, amounted to BD 102 million (2004: BD 72.2 million). The assets sold under repurchase agreements were non trading investment securities of the Group amounting to BD 101.6 million (2004: BD 67.4 million).

12 MEDIUM TERM DEPOSITS FROM BANKS

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

Amount of facility US$ '000	Rate of interest	Maturity (Year)	Carrying amount 2005 BD '000	Carrying amount 2004 BD '000
125,000	Libor + 0.485%	2006	**47,125**	47,125
125,000	Libor + 0.425% to 2007 Libor + 0.450% from 2008	2009	**47,125**	47,125
			94,250	94,250

13 INTEREST PAYABLE AND OTHER LIABILITIES

	2005 BD '000	2004 BD '000
Interest payable	**8,554**	4,941
Accounts payable	**5,730**	6,953
Accrued expenses	**11,856**	8,897
Negative fair value of derivates (Note 25)	**207**	1,105
Other	**1,142**	1,321
	27,489	23,217

14 SHARE CAPITAL AND TREASURY STOCK

	2005 BD '000	2004 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 Group of its own shares. At the end of the year, the Group held 4,869,666 shares (2004: 4,369,666) 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 distributable subject to the approval of the Bahrain Monetary Agency.

16 CUMULATIVE CHANGES IN FAIR VALUES

	2005 BD '000	2004 BD '000
Available-for-sale investments		
At 1 January	**23,184**	4,370
Adjustment arising from the application of IAS 39 (revised)	**-**	11,603
Realised in the year	**(1,699)**	(3,489)
Net movement in fair values during the year	**7,455**	10,700
At 31 December	**28,940**	23,184
Cash flow hedges		
At 1 January	**(258)**	(384)
Change in unrealised fair values during the year	**769**	(63)
Change in unrealised fair values - associated company (Note 8)	**199**	189
At 31 December	**710**	(258)
	29,650	22,926

17 PROPOSED APPROPRIATIONS

	2005 BD '000	2004 BD '000
Dividend	**19,747**	19,764
Directors' remuneration	**390**	260
Donations	**600**	600
Bonus shares	**7,113**	-
	27,850	20,624

The directors have proposed a cash dividend of 35% being BD 0.035 per share (2004: BD 0.035 per share), net of treasury stock. The directors have also proposed a bonus issue of one share for every eight shares held.

The above appropriations will be submitted for formal approval at the Annual General Meeting to be held on 26 February 2006.

18 INTEREST INCOME

	2005 BD '000	2004 BD '000
Treasury bills	**1,360**	1,508
Deposits and due from banks and other financial institutions	**7,997**	4,087
Loans and advances to customers	**50,387**	35,313
Non trading investment securities	**14,004**	9,311
Notional interest on impaired financial assets	**868**	565
	74,616	50,784

19 INTEREST EXPENSE

	2005 BD '000	2004 BD '000
Deposits and due to banks and other financial institutions	**15,105**	9,948
Term loans	**-**	139
Customers' current, savings and other deposits	**23,801**	11,172
	38,906	21,259

20 OTHER INCOME

	2005 BD '000	2004 BD '000
Fees and commission income	**12,218**	12,508
Fees and commission expense	(**1,158**)	(1,780)
	11,060	10,728
Dividend income	**2,206**	2,536
Realised gain on non-trading investments	**1,699**	6,013
Income from managed funds	**897**	855
Trading income	**134**	(96)
Gain on foreign exchange	**1,648**	1,389
Other	**961**	986
	7,545	11,683
	18,605	22,411

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:

	2005	2004
Net profit for the year (BD '000)	**29,328**	25,678
Weighted average number of shares, net of treasury stock, outstanding during the year	**564,487,548**	564,692,834
Basic earnings per share (BD)	**0.052**	0.045

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.

22 SEGMENTAL INFORMATION continued

Primary segment information continued

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.

Segment information for the year ended 31 December 2005 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	21,081	18,757	31,039	22,344		93,221
Inter- segmental revenue	11,130	12,772	2,849	34,732	(61,483)	-
Total revenue	32,211	31,529	33,888	57,076	(61,483)	93,221
Segment result	8,973	6,609	6,329	5,846		27,757
Income from associate						1,571
Net profit for the year						29,328
Segment assets	168,796	308,846	578,048	416,911		1,472,601
Investment in associated companies						9,272
Common assets						16,904
Total assets						1,498,777
Segment liabilities	311,788	376,744	393,134	232,948		1,314,614
Common liabilities						10,770
Total liabilities						1,325,384

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
Income from associate						1,251
Net profit for the year						25,678
Segment assets	156,274	268,904	566,219	409,537		1,400,934
Investment in associated companies						5,812
Common assets						14,074
Total assets						1,420,820
Segment liabilities	290,531	328,852	386,181	246,240		1,251,804
Common liabilities						11,193
Total liabilities						1,262,997

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	
	2005 BD '000	2004 BD '000	**2005 BD '000**	2004 BD '000	**2005 BD '000**	2004 BD '000
Operating income before provisions	**38,592**	38,981	**15,723**	12,955	**54,315**	51,936
Total assets	**1,206,307**	1,080,510	**292,470**	340,310	**1,498,777**	1,420,820

23 CASH AND CASH EQUIVALENTS

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

	2005 BD '000	2004 BD '000
Cash and balances with Central Bank	**25,965**	16,417
Treasury bills	**23,806**	19,932
Deposits and due from banks and other financial institutions with an original maturity within ninety days	**92,582**	138,864
Cash and cash equivalents	**142,353**	175,213

24 RELATED PARTY TRANSACTIONS

Certain related parties (principally the major shareholders, associated companies, directors and key 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:

	Major shareholders BD '000	**Associate and others BD '000**	**Directors and key management BD '000**	**Total 2005 BD '000**	2004 BD '000
Placements and loans and advances to customers	**29,200**	**6,574**	**373**	**36,147**	10,589
Non-trading investment securities	**150**	**4,964**	**-**	**5,114**	681
Borrowings and deposits from customers	**149,463**	**1,162**	**2,247**	**152,872**	152,586
Credit commitments	**-**	**39**	**-**	**39**	1,877

No provision is required in respect of loans given to related parties (2004: nil).
The income and expenses in respect of related parties included in the consolidated income statement are as follows:

	Major shareholders BD '000	**Associate and others BD '000**	**Directors and key management BD '000**	**Total 2005 BD '000**	2004 BD '000
Interest income on loans and advances to customers	**958**	**261**	**4**	**1,223**	166
Interest income on investment	**-**	**115**	**-**	**115**	-
Gain on non-trading investment securities	**-**	**28**	**-**	**28**	42
Interest expense on deposits	**5,250**	**176**	**60**	**5,486**	2,728

24 RELATED PARTY TRANSACTIONS continued

Compensation of the key management personnel is as follows:

	2005 BD '000	2004 BD '000
Short term employee benefits	**2,180**	2,059
Others	**37**	235
Total compensation paid to key management personnel	**2,217**	2,294

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.

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 but are neither indicative of the market risk nor credit risk.

				Notional amounts by term to maturity		
31 December 2005	**Positive fair value BD '000**	**Negative fair value BD '000**	**Notional amount Total BD '000**	**within 3 months BD '000**	**3 - 12 months BD '000**	**1 - 5 years BD '000**
Derivatives held for trading:						
Forward foreign exchange contracts	**89**	**84**	**22,034**	**12,459**	**9,575**	**-**
Derivatives held as fair value hedges:						
Interest rate swaps	**436**	**44**	**20,972**	**-**	**-**	**20,972**
Forward foreign exchange contracts	**24**	**79**	**112,634**	**107,347**	**5,287**	**-**
Derivatives held as cash flow hedges:						
Interest rate swaps	**705**	**-**	**47,314**	**-**	**22,620**	**24,694**
	1,254	**207**	**202,954**	**119,806**	**37,482**	**45,666**

				Notional amounts by term to maturity		
31 December 2004	Positive fair value BD '000	Negative fair value BD '000	Notional amount Total BD '000	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

25 DERIVATIVES continued

Derivative product types

Forwards 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

The primary purpose of these instruments is to ensure that the funds are available to the customers as required. 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 represent unused portion of contractual commitments to make loans and revolving credits, principally in the form of loans and advances, guarantees and letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of loss, which can not readily be quantified, is expected to be considerably less than the total unused commitment as most of commitments to extend credit are contingent upon customer maintaining specific credit standards. 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:

	2005 BD '000	2004 BD '000
Commitments on behalf of customers:		
Letters of credit	**63,115**	45,146
Guarantees	**177,275**	145,246
Acceptances	**8,293**	7,553
	248,683	197,945
Irrevocable commitments		
Undrawn loan commitments	**47,397**	44,641
Commitments in respect of investments	**2,403**	4,083
	49,800	48,724
	298,483	246,669

As at 31 December 2005, the Group also has capital commitments of BD 0.6 million (31 December 2004: 1.3 million).

	2005 BD '000	2004 BD '000
Irrecoverable commitments to extend credit:		
Original term to maturity of one year or less	**27,157**	14,009
Original term to maturity of more than one year	**22,643**	34,715
	49,800	48,724

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, functioning independent of the business unit and who is also 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:

	2005			2004		
	Assets BD '000	Liabilities BD '000	Credit commitments BD '000	Assets BD '000	Liabilities BD '000	Credit commitments BD '000
Geographical region:						
Gulf Co-operation Council countries	**1,206,307**	**1,139,191**	**177,850**	1,080,510	1,104,307	152,346
North America	**75,438**	**11,831**	**2,522**	85,765	3,503	4,200
European Union countries	**129,078**	**152,995**	**81,345**	132,218	138,561	52,959
Asia	**66,869**	**18,817**	**33,598**	80,659	13,894	37,076
Others	**21,085**	**2,550**	**3,768**	41,668	2,732	1,418
	1,498,777	**1,325,384**	**299,083**	1,420,820	1,262,997	247,999
Industry sector:						
Trading and manufacturing	**316,280**	**66,230**	**88,021**	289,346	60,524	62,334
Banks and other financial institutions	**406,119**	**447,225**	**126,472**	513,918	456,433	124,040
Construction and real estate	**102,366**	**42,122**	**32,711**	91,307	15,009	23,689
Government and public sector	**305,981**	**235,273**	**8,470**	223,139	206,238	-
Individuals	**226,884**	**331,834**	**12,207**	222,135	318,615	41
Others	**141,147**	**202,700**	**31,202**	80,975	206,178	37,895
	1,498,777	**1,325,384**	**299,083**	1,420,820	1,262,997	247,999
Month end average	**1,575,241**	**1,413,627**	**258,397**	1,400,616	1,255,953	220,787

29 MARKET RISK

Market risk is defined as the risk of losses in the Group's on or off balance sheet positions or changes in fair values of financial instruments 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. The Group does not undertake any commodity trading activities. For management of market risk arising from movement in interest rates, refer note 30.

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

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 2005	Less than One month BD '000	one month to three months BD '000	three months to six months BD '000	six months to one year BD '000	one year to five years BD '000	Over five years BD '000	Not exposed to interest rate risk BD '000	Total BD '000
ASSETS								
Cash and balances with central banks	9,038	-	-	-	-	-	40,648	49,686
Treasury bills	9,961	13,845	-	-	-	-	-	23,806
Trading investments	10	-	-	-	-	-	-	10
Deposits and due from banks and other financial institutions	78,335	32,421	17,400	-	-	-	2,557	130,713
Loans and advances to customers	312,528	187,036	141,320	14,183	32,952	87,732	19,255	795,006
Non-trading investment securities	10,493	168,077	95,270	80,054	11,123	39,666	52,793	457,476
Investment in associated companies	-	-	-	-	-	-	9,272	9,272
Interest receivable and other assets	-	-	-	-	-	-	16,009	16,009
Premises and equipment	-	-	-	-	-	-	16,799	16,799
Total assets	420,365	401,379	253,990	94,237	44,075	127,398	157,333	1,498,777
LIABILITIES AND EQUITY								
Deposits and due to banks and other financial institutions	201,713	29,276	4,610	137	-	-	2,506	238,242
Borrowings under repurchase agreements	1,753	100,250	-	-	-	-	-	102,003
Medium term deposits from banks	18,850	75,400	-	-	-	-	-	94,250
Customers' current, savings and other deposits	511,729	140,228	37,939	41,393	3,106	-	129,005	863,400
Interest payable and other liabilities	-	-	-	-	-	-	27,489	27,489
Equity	-	-	-	-	-	-	173,393	173,393
Total liabilities and equity	734,045	345,154	42,549	41,530	3,106	-	332,393	1,498,777
On-balance sheet gap	(313,680)	56,225	211,441	52,707	40,969	127,398	(175,060)	
Off-balance sheet gap	4,524	4,204	12,245	-	(15,318)	(5,655)	-	
Total interest rate sensitivity gap	(309,156)	60,429	223,686	52,707	25,651	121,743	(175,060)	
Cumulative interest rate sensitivity gap	(309,156)	(248,727)	(25,041)	27,666	53,317	175,060	-	

30 INTEREST RATE RISK MANAGEMENT continued

As of 31 December 2004	Less than One month BD '000	one month to three months BD '000	three months to six months BD '000	six months to one year BD '000	one year to five years BD '000	Over five years BD '000	Not exposed to interest rate risk BD '000	Total BD '000
ASSETS								
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	107,867	28,054	66,769	97,908	13,205	764,689
Non-trading investment securities	30,311	128,818	59,173	74,304	17,627	19,587	46,355	376,175
Investment in associated companies	-	-	-	-	-	-	5,812	5,812
Interest receivable and other assets	-	-	-	-	-	-	11,292	11,292
Premises and equipment	-	-	-	-	-	-	14,580	14,580
Total assets	542,324	267,521	179,445	102,358	84,396	117,495	127,281	1,420,820
LIABILITIES AND EQUITY								
Deposits and due to banks and other financial institutions	123,671	80,025	4,657	6,571	-	-	13,928	228,852
Borrowings under repurchase agreements	-	72,176	-	-	-	-	-	72,176
Medium term deposits from banks	-	47,125	47,125	-	-	-	-	94,250
Customers' current, savings and other deposits	472,690	159,695	88,042	12,076	11,452	2,680	97,867	844,502
Interest payable and other liabilities	-	-	-	-	-	-	23,217	23,217
Equity	-	-	-	-	-	-	157,823	157,823
Total liabilities and equity	596,361	359,021	139,824	18,647	11,452	2,680	292,835	1,420,820
On-balance sheet gap	(54,037)	(91,500)	39,621	83,711	72,944	114,815	(165,554)	
Off-balance sheet gap	23,411	54,488	5,664	(31,209)	(52,354)	-	-	
Total interest rate sensitivity gap	(30,626)	(37,012)	45,285	52,502	20,590	114,815	(165,554)	
Cumulative interest rate sensitivity gap	(30,626)	(67,638)	(22,353)	30,149	50,739	165,554	-	

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 INTERESTRATE RISK MANAGEMENT continued

	31 December 2005 Effective interest rate %			31 December 2004 Effective interest rate %		
	BD	**KD**	**US$**	BD	KD	US$
Assets						
Treasury bills	**3.3**	**2.3**	**-**	1.3	2.3	-
Deposits and due from banks and financial institutions	**3.5**	**3.2**	**3.3**	1.5	2.7	1.5
Loans and advances to customers (x)	**7.4**	**7.5**	**4.4**	5.8	4.8	2.3
Non-trading investment securities	**4.1**	**2.8**	**4.4**	1.7	2.8	3.0
Liabilities						
Deposits and due to banks and other financial institutions	**3.2**	**3.0**	**3.4**	1.3	2.4	1.7
Term loans	**-**	**-**	**-**	-	-	-
Medium term deposits from banks	**-**	**-**	**3.7**	-	-	2.0
Customers' current, savings and other deposits (xx)	**1.9**	**0.9**	**3.1**	0.7	0.9	1.5

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

(xx) The effective interest rates 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:

	2005 BD '000 equivalent long (short)	2004 BD '000 equivalent long (short)
US dollars	**75,167**	66,816
Euro	**175**	(1,449)
G.C.C. currencies	**2,022**	164
Others	**592**	(161)

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 2005	Less than 1 month BD '000	1 month to 3 months BD '000	3 months to 6 months BD '000	6 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	25,924	41	407	274	1,057	8	-	-	21,975	49,686
Treasury bills	9,961	13,845	-	-	-	-	-	-	-	23,806
Trading investments	10	-	-	-	-	-	-	-	-	10
Deposits and due from banks and other financial institutions	80,893	32,421	17,399	-	-	-	-	-	-	130,713
Loans and advances to customers	41,666	87,148	84,409	91,987	242,076	211,222	36,498	-	-	795,006
Non-trading investment securities	-	36,655	51,577	72,896	145,433	107,453	-	-	43,462	457,476
Investment in associated company	-	-	-	-	-	-	-	-	9,272	9,272
Interest receivable and other assets	11,549	1,694	101	13	2,247	335	70	-	-	16,009
Premises and equipment	-	-	-	-	-	-	-	-	16,799	16,799
Total assets	170,003	171,804	153,893	165,170	390,813	319,018	36,568	-	91,508	1,498,777
LIABILITIES										
Deposits and due to banks and other financial institutions	204,219	29,276	4,610	137	-	-	-	-	-	238,242
Borrowings under repurchase agreements	1,753	100,250	-	-	-	-	-	-	-	102,003
Medium term deposits from banks	-	-	-	47,125	47,125	-	-	-	-	94,250
Customers' current, savings and other deposits	637,437	138,963	32,273	37,850	16,857	20	-	-	-	863,400
Interest payable and other liabilities	27,006	104	60	60	147	112	-	-	-	27,489
Total liabilities	870,415	268,593	36,943	85,172	64,129	132	-	-	-	1,325,384
Net liquidity gap	(700,412)	(96,789)	116,950	79,998	326,684	318,886	36,568	-	91,508	173,393

33 LIQUIDITY RISK continued

As of 31 December 2004	Less than 1 month BD '000	1 month to 3 months BD '000	3 months to 6 months BD '000	6 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	198	243	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	46,554	39,392	256,566	186,217	38,885	-	-	764,689
Non-trading investment securities	1,736	20,463	25,752	77,312	116,625	94,704	1,557	50	37,976	376,175
Investment in associated company	-	-	-	-	-	-	-	-	5,812	5,812
Interest receivable and other assets	6,707	1,382	276	561	2,133	-	31	-	202	11,292
Premises and equipment	-	-	-	-	-	-	-	-	14,580	14,580
Total assets	345,107	98,859	79,681	123,011	375,923	280,921	40,473	60	76,785	1,420,820
LIABILITIES										
Deposits and due to banks and other financial institutions	137,599	80,025	4,637	6,591	-	-	-	-	-	228,852
Borrowings under repurchase agreements	-	72,176	-	-	-	-	-	-	-	72,176
Medium term deposits from banks	-	-	-	-	94,250	-	-	-	-	94,250
Customers' current, savings and other deposits	570,554	159,695	45,111	55,007	11,452	2,683	-	-	-	844,502
Interest payable and other liabilities	22,203	-	199	506	205	-	-	-	104	23,217
Total liabilities	730,356	311,896	49,947	62,104	105,907	2,683	-	-	104	1,262,997
Net liquidity gap	(385,249)	(213,037)	29,734	60,907	270,016	278,238	40,473	60	76,681	157,823

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 53.6 million (31 December 2004: BD 54.7 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 2005			31 December 2004		
	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

As explained in note 7, included under non-trading investments are unquoted investments amounting to BD 19.4 million (2004: BD 33.8 million) for which fair value cannot be reliably determined.

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:

	2005 BD '000	2004 BD '000
Capital base:		
Tier 1 capital	**115,155**	110,581
Tier 2 capital	**60,586**	49,531
Total capital base (a)	**175,741**	160,112
Credit risk weighted exposure:		
On-balance sheet	**813,934**	748,459
Off-balance sheet	**76,519**	94,228
Total	**890,453**	842,687
Market risk weighted exposure:		
On-balance sheet	**-**	-
Off-balance sheet	**7,683**	7,993
Total	**7,683**	7,993
Total risk weighted exposure (b)	**898,136**	850,680
Capital adequacy (a/b * 100)	**19.57%**	18.82%
Minimum requirement	**12%**	12%

38 LEGAL CLAIMS

As at 31 December 2005, there were legal suits pending against the Group aggregating BD 1.9 million (2004: BD 1.3 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.