ANNUAL REPORT 2006

Ithmaar Bank

H.H. Shaikh Khalifa
Bin Salman Al Khalifa

The Prime Minister of the
Kingdom of Bahrain

H.M. King Hamad
Bin Isa Al Khalifa

The King of Bahrain

H.H. Shaikh Salman
Bin Hamad Al Khalifa

The Crown Prince of the
Kingdom of Bahrain and
Commander-in-Chief of the
Bahrain Defence Force

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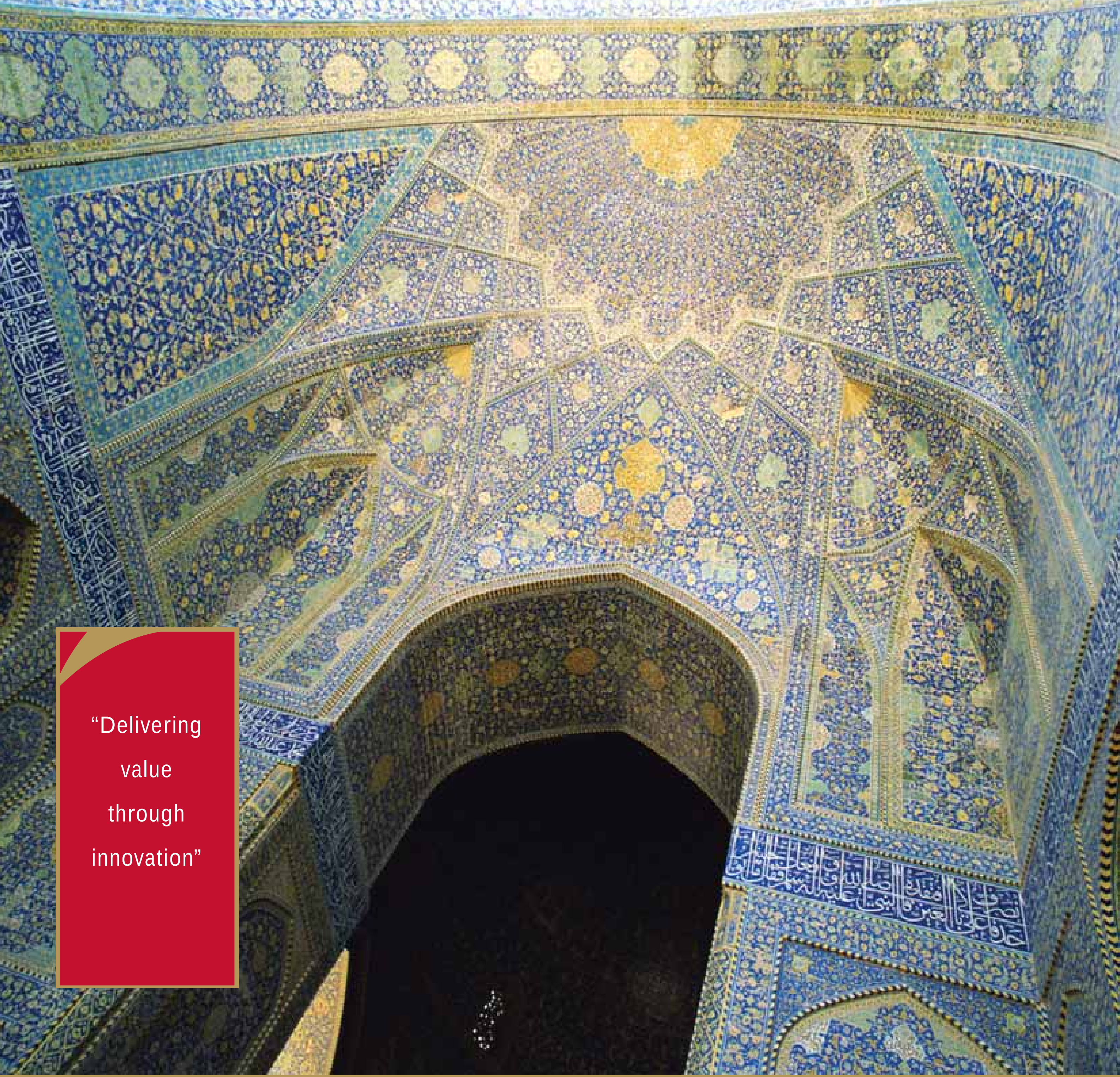


"Delivering value through innovation"

Introduction

Standing at the crossroads of East and West, Islamic and Arab artists were not only well situated to spread their influence, but equally influenced by other cultures.

Muslims and Arabs were, and still are great travellers and explorers, philosophers and imaginative scientists. Their artistic heritage portrays their interests and endeavours; the astrolabe of the astronomer, the intricate beauty of ceramic tiles, the swirls and colours of calligraphy, vibrant story manuscripts and beautiful objects with endless geometric patterns and designs.

Just as its ancestors, Ithmaar Bank takes pride in its pioneering vision and innate powers of imagination, creating growth through innovation.

Mosjed-Eman Mosque,
Isfahan, Iran

"Strength through innovation and expertise"

Our Vision

- To be the benchmark international investment bank from the Middle East; and,
- With our subsidiaries and affiliates, the premier global Islamic financial services group.

Our Mission

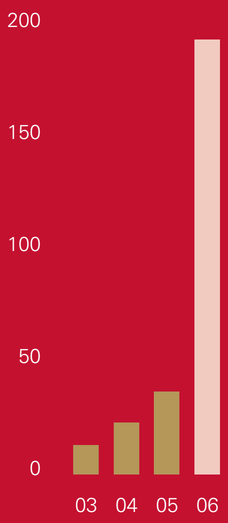
- While being an exemplary corporate citizen and employer, to deliver superior returns to our shareholders.
- To provide excellent service and value to our multilateral, governmental, corporate, financial, institutional and high net-worth clients, through a wide range of Islamic financial services. These include: investment, commercial and private banking, private equity, private issue of securities, mergers and acquisitions advice, Takaful, equipment leasing and real estate development.

Our Values

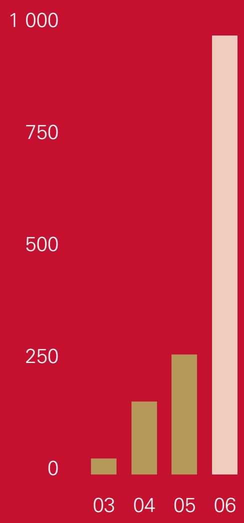
- Heritage
- Expertise
- Innovation
- Vision
- Sophistication
- International Focus

Steel helmet with engraved and gilded decoration, 18th century.

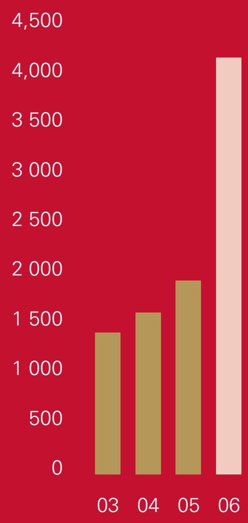
Financial Highlights



Net profit (US$ million)



Total equity (US$ million)



Total assets (US$ million)
(including funds
under management)

Financial Highlights

		2003	2004	2005	2006
Net profit	(US$ million)	14.2	22.1	37.6	183.8
Net profit attributable to shareholders	(US$ million)	13.8	22.1	36.5	168.2
Total equity	(US$ million)	67.0	219.3	252.8	984.8
Total equity attributable to shareholders	(US$ million)	62.4	214.5	247.4	758.5
Net book value per share	(US$)	2.08	1.43	1.65	2.15
Earnings per share	(US cents)	-	18	24	55
Total assets	(US$ million)	409	435	442	3,180
Funds under management	(US$ million)	1,000	1,100	1,500	1,100
Return on average equity	(%)	-	16.0	15.8	33.4
Return on average paid-in capital	(%)	-	18.4	24.4	55.0
Cost to operating income ratio	(%)	96	79	69	41
Dividends	(US$ million)	-	10.0	20.0	47.7
Dividends per share	(US cents)	-	6.7	13.3	13.5
Capital adequacy	(%)	32.5	37.3	36.8	18.1

"We believe that banking is all about people"

Chairman's Message

In the name of Allah, most Gracious, most Merciful

It gives me great pleasure to present the Annual Report of Ithmaar Bank for the year ended 31 December 2006.

I am delighted to report that the Bank has posted record profits of US$183.8 million compared to US$37.6 million in 2005, reflecting excellent results for our shareholders. Return on equity was 33.4 per cent while return on paid-up capital was 55.0 per cent.

The Bank's operating profit rose to US$70.0 million, compared to US$13.5 million in 2005. Assets stood at US$3.2 billion, excluding US$1.1 billion in funds under management, again another strong increase from the 2005 year-end figure which was US$ 442 million.

The group's total equity recorded an increase of 290%, from US$252.8 million at the end of 2005 to US$984.8 million at the end of 2006.

Amidst such highly rated performance results, the Bank's Board of Directors proposed a cash dividend of 13.5 cents per share. This dividend translates to over 6 per cent yield on the current market value of our shares. In line with the majority of the companies listed on the Bahrain Stock Exchange, and in order to provide a wider base for trading, the Board is recommending to the General Assembly a split of the Bank's shares into 4:1 of US cents 25 each, thereby increasing the number of tradable shares four fold.

The year 2006 saw the Bank raise its total paid-up capital from US$150 million to its current US$360 million, through a private placement of 60,000,000 new shares of the Bank and an IPO of 150,000,000 shares. This demonstration of investor confidence raised a total of US$ 397.5 million and reconstituted the Bank as a Bahraini Public Shareholding Company.

In August, the acquisition of a controlling 60 per cent shareholding in Shamil Bank of Bahrain from DMI Trust, for a total of $401.3 million, also allowed the Bank to indirectly gain controlling interests in Faisal Private Bank (Switzerland) and Faisal Bank Limited (Pakistan), as well as strengthen its ownership of Faisal Finance Limited (Jersey).

Ithmaar Bank also disposed of 100% of its investment in Islamic Investment Company of the Gulf (Bahamas) to DMI Trust for US$150 million, out of which US$105.5 million was accounted as profit. In September, the Bank sold 7.5% of its investment in Faisal Islamic Bank of Egypt to DMI Trust for a total of $18.8 million. Faisal Private Bank S.A. (Geneva), was granted a full banking license

Eye-shaped structure
Nijima Island,
Tokyo - Japan.

by the Swiss authorities and became the first Islamic private bank in Switzerland.

The efforts to consolidate the Bank's assets have been complemented by new strategic investments. This saw the Bank acquire a 20 per cent shareholding in CITIC International Assets Management Limited (CIAM), investing a total of US$60 million, of which US$24 million has been paid up, with the balance payable within two years. CIAM, which specializes in investments in China, is partly owned by the CITIC Group, a major Chinese international conglomerate.

"We conduct our business using creativity and vision"

These carefully selected acquisitions will allow us to extend our range of services and strategically operate within a wider geographical scope. Ithmaar Bank is now a strong investment bank with operations spanning the Middle East, Europe, Asia and North Africa.

Utilizing these accomplishments as a solid pillar for further growth, we have launched a US$2 billion Infrastructure and Growth Capital Fund (IGCF), together with Abraaj Capital and Deutsche Bank. This will be one of the largest funds ever raised in the region, aimed to target a number of strategic investment opportunities including power and utilities, water, health care, education, transportation, oil and gas, petrochemical and mining.

Ithmaar Bank's subsidiaries and affiliates significantly contributed towards achieving our financial results. The Bank gives its subsidiaries and affiliates all the necessary backing and support they need to develop their operations and services.

Shamil Bank of Bahrain recorded net profits of US$ 61.6 million at the end of 2006, a 57% rise compared to 2005 year-end results. First Leasing Bank raised its paid-up capital to US$ 100 million though a private placement offer that was a landmark operation for the leasing industry in the GCC. Solidarity continued its expansion into international markets, posting net profits of US$ 5.4 million in 2006. Faisal Private Bank and Faysal Bank Limited, recorded net profits of US$7.6 million and US$54.6 million respectively.

The creativity and vision in the way we conduct our business and select our projects are two factors that we feel confident with and upon which we will be building our future. We now have a solid foundation that undoubtedly will lead us to many equally successful years to come. We have always valued our staff members and we have been vigilantly working to further reinforce them. Our emphasis is on finding the right people who will have the capability and fortitude to keep up with the Bank's resolute progressiveness.

I would like to take this opportunity to welcome our new CEO Michael P. Lee, whose arrival will have an unquestionably significant impact on our future direction. Michael's broad international experience and deep understanding of the international and regional markets will be a tremendous asset to Ithmaar Bank as it continues to pursue its aggressive growth-oriented strategy.

From a corporate social responsibility viewpoint, I am pleased to announce that Ithmaar Bank has taken the necessary steps to establish the "Ithmaar education & training fund", in coordination with top-tier universities in the United Kingdom. This fund will significantly contribute in providing a platform for high level students in Bahrain and in the region. The fund will focus on benefiting those students with less access to proper financial resources and orphans, who would otherwise not be able to afford such an education.

Our plans for 2007 are exciting and promising and we will continue to transform in pursuit of our vision and mission. As a publicly traded company, maximizing our shareholders' value is a central goal. To our investors, who are critical to our success, we promise dedication and uncompromising commitment, and as always, our strong foundation and expertise will provide the most innovative financial services in the market.

Khalid Abdulla-Janahi

Chairman

Board of Directors

Composition and Board Balance:

The Board presently has ten directors, comprising six independent directors and four other directors representing the interests of Dar Al-Maal Al-Islami Trust (DMI Trust). The number of directors on the Board is established by the Bank's Memorandum and Articles of Association. The Board of Directors is headed by a Chairman who is considered to be an independent director in accordance with the Central Bank of Bahrain's guidelines and international best practice.

As of 31 December 2006, the Board of Directors comprised:

Khalid Abdulla-Janahi (Chairman), is the Group Chief Executive of Dar Al-Maal Al-Islami (DMI); Chairman of Faisal Private Bank (Switzerland), DMI Administrative Services, First Leasing Bank and IICG (Bahamas). Chairman of the Executive Committee of the Board of Faysal Bank Limited (Pakistan), and Solidarity. He is a member of the Board of Shamil Bank of Bahrain and Faisal Islamic Bank of Egypt. He is currently a member of the Economic Development Board of Bahrain, Vice Chairman of the Arab Business Council, and a Member of the Board of the Centre for International Business and Management (CIBAM), University of Cambridge, UK. A Fellow of the Institute of Chartered Accountants in England and Wales. Mr. Janahi holds a degree in Computer Science and Accountancy from the University of Manchester, UK.

Tunku Dato' Ya'acob Bin Tunku Abdullah, is the Deputy Chairman of MAA Holdings Berhad (Malaysia), which he joined in 1999. Prior to his current position, Prince Ya'acob worked for 19 years for Malaysian Assurance Alliance Berhad (Insurance Company), where his last position was as Chairman of the Company. He also worked at Price Waterhouse London (UK), and Malaysia, where he held the position of Assistant Manager in their offices in Kuala Lumpur. Prince Ya'acob holds a Bachelor of Science with Honours from The City University in London and is a fellow member of the Institute of Chartered Accountants of England and Wales.

Abdulhameed M. Aboumoussa, is the Governor of Faisal Islamic Bank of Egypt, which he joined in 1977. Prior to his current position, Mr. Aboumoussa worked in the Central Bank of Egypt for 16 years. He holds a Bachelor of Science in Accounting and a diploma in finance from Cairo University in Egypt, and holds a diploma in Banking Economics from Lwegi Boconi University in Milano, Italy. He is a member of the coordinating council that determines the monetory and fiscal policy objectives of the Egyptian Economy.

Mohamed Bin Saif Al Mezrouei, is the Chief Executive Officer of the UAE Offsets Group. Since he joined the group in 1994 as a project manager, he has been appointed Deputy Chairman in 1996 and member of the Board in early 2000. Prior to joining the group he was the Human Resources Manager of Abu Dhabi National Oil Company (ADNOC) for eight years. Mr. Al Mezrouei is also a member of the Board of Directors of Mubadala Development Company and Chairman of the National Central Cooling Company (Tabreed). He also serves on the Board of Directors of other prominent companies such as Dolphin Energy Limited, Abu Dhabi Tourism Authority, Abu Dhabi Water & Electricity Authority, Al Ain Zoo, the Emirates Media Incorporation and Tourism & Development Investment Company. Mr. Al Mezrouei has a degree in Business Administration from the Laverne University in USA.

Farook Bengali, is the President and Chief Executive Officer of Faysal Bank Limited (Pakistan), responsible for the management and day-to-day business of the Bank. Prior to joining FBL in 1996, Mr. Bengali worked for almost 30 years for Standard Chartered Bank (Pakistan), where his last position was Chief Executive, with overall responsibility for the operations of the Bank and its branches throughout the country. Mr. Bengali is a Fellow of the Chartered Institute of Bankers (UK), a member of the Institute of Bankers in Pakistan and holds Masters Degrees in both economics and law.

Sheikh Mohammed Youseef El Khereiji, comes from one of the leading merchant families in the Kingdom of Saudi Arabia. He studied in Switzerland and the United Kingdom and graduated with an MBA in Marketing and Finance. He started his career as a consultant and financial advisor for many prominent financial institutions such as Prudential Bache and BNP Paribas in Geneva. He is currently Chairman of Global Investment and Marketing S.A. (Geneva) and Creative Investment and Marketing S.A. He is

Chief Financial Officer of El Khereiji Group, Chairman of SAGE Capital Management Group in Bahrain and Marriot European Hotel Operating Co. Ltd. Sheikh El Khereiji is also Honorary Chairman of the Swiss Red Cross and is an active contributor to many charitable entities. He also holds numerous other prominent executive Board positions in Europe and the Middle East.

Sheikha Hissah Bint Saad Al-Sabah, is the President of the Council of Arab Businesswomen. Sheikha Al-Sabah has had a long history in Government and private volunteer service, including: Department of Medical Services, Research and Development, Military Hospital, Ministry of Defence; Adviser, Defence Minister's Office Kuwait; Chairperson of the Narcotics Control Committee; Kuwait Volunteers Women Society; Kuwait Businesswomen Committee; Arab African Women's Council; Honorary Chairperson, Arab Federation of Non-Government Societies for Addiction Prevention; Deputy Chairperson of the Kuwait Narcotics Control Committee; Member of the National Committee for Narcotics Control; the International Council of Alcohol and Addiction. Sheikha Al-Sabah studied Public Administration and Political Science in the American University, Beirut.

Khalil Nooruddin, is the Director of the Bahrain Institute of Banking and Finance. Prior to assuming this assignment in 2004, Mr. Nooruddin worked for twenty years as a corporate and investment banker. His last assignment in this field was with Investcorp Bank, where he served as a member of the firm's Management Committee for ten years. Before Investcorp, he served as a corporate banker with Chase Manhattan Bank in Bahrain and as an investment banking professional with Chase Investors Management Corporation and UBS Asset Management in London and Zurich. Before his banking career, he worked as an operations research analyst with Bahrain Petroleum Company (Bapco) in Bahrain and Caltex Petroleum Corporation in New York. Mr. Nooruddin is a Chartered Financial Analyst, holds a Master of Science degree in Quantitative Analysis from Stern Business School in New York University and a Bachelor of Science degree in Systems Engineering from the University of Petroleum and Minerals, Kingdom of Saudi Arabia. He is an active member of several civil and professional societies in the Kingdom of Bahrain.

Ziad Hasan Rawashdeh, is the Chairman of the Executive Committee of Shamil Bank of Bahrain, Member of the Board of Faysal Bank Ltd., (Pakistan), Group Chief Operating Officer of Dar Al-Maal Al-Islami and Vice-Chairman of Faisal Private Bank S.A. (Switzerland). He is also Chairman or a Board Member of a number of other DMI Group subsidiaries. Previous positions include Chief Executive Officer of Faisal Private Bank S.A. (Switzerland), Managing Director of Islamic Investment Company of the Gulf (IICG), and several key positions in the DMI Group and other financial institutions. A Fellow of the Arab Institute for Banking and Financial Studies, Mr. Rawashdeh holds a B.Sc. in Economics.

Graham Roderick Walker, is the Finance Director of Ithmaar Bank B.S.C. and is the Group Head of Finance and Risk Management of DMI. Prior to joining DMI in 2000, Mr. Walker held various senior management positions with a number of major international financial institutions, including HSBC, Standard Chartered Bank and Foreign & Colonial Management Limited. He has worked in Europe, North America and Asia and has wide ranging experience in banking and financial services. He is a member of the Institute of Chartered Accountants of Scotland.

Meetings

In accordance with its Articles of Association, the Board of Directors meets at least four times a year, and the Board expects each director to attend at least 50% of all Board meetings and meetings of committees on which they serve.

Executive Management

Michael P. Lee - Chief Executive Officer

Mr. Lee is a seasoned banker with over 34 years of experience as an international investment banker serving multilateral, governmental, corporate, financial institutional and high net-worth clients. He has a deep knowledge of the MENA and South Asia regions, having been based in the Kingdom of Bahrain since 1992. In his earlier career, with assignments based in London, Hong Kong and New York, he served investment banking clients in Western and Eastern Europe, Africa, Asia Pacific, North and South America. Prior to joining Ithmaar Bank, he was Deputy Chairman and Managing Director of Emerging Markets Partnership (Bahrain), the general partner and manager of the US$ 930.5 million Islamic Development Bank (IDB) Infrastructure Fund. This pioneering regional private equity fund, headquartered in the Kingdom of Bahrain and investing in private sector infrastructure, was co-founded by IDB, DMI Trust and EMP.

Mr. Lee started his career in 1973, as an investment banker at Merrill Lynch, spending over 10 years in London, Hong Kong and New York in commercial and investment banking, and general management. From 1979-81, he was Director of Corporate Development, Merrill Lynch International & Co., New York and, from 1981-84, as Managing Director, he headed Merrill Lynch's international investment banking group responsible for Financial Institutions/Private Placements. From 1984-88, Mr. Lee was the Chief Executive Officer of Dean Witter Capital Markets International Ltd., London and Managing Director, Corporate Finance of Dean Witter Reynolds Inc., New York. In 1992, Mr. Lee became a senior advisor at Bahrain's Ministry of Finance & National Economy, providing *inter alia* strategic advice on the development and regulation of the Bahrain International Financial Centre.
Mr. Lee holds an MA (Honours) in Philosophy, Politics and Economics from the University of Oxford.

Salman A. Al-Khalifa – Managing Director Private Banking

Prior to joining the Bank, Sheikh Salman A. Al-Khalifa, held a range of positions within both the private and public sectors, both regionally and internationally. He previously served as Director of Banking Services at the Bahrain Monetary Agency (BMA) and held the position of Vice Chairman of the International Islamic Financial Market, one of the core infrastructure institutions of the Islamic Banking and Finance Industry. During his tenures at Barclays Capital and Bear Stearns in London, Sheikh Salman A. Al-Khalifa managed a range of investment banking relationships and marketed various securities and structured products to Middle East markets. He has a Bachelors of Science degree in Finance from the American University, Washington D.C.

Mohammad Khan Hoti - Managing Director Investments

Prior to joining Ithmaar Bank, Mr. Hoti was the General Manager, Investment Banking of Faysal Bank Limited, which he joined in 1996. He has wide experience of both commercial and investment banking and has held senior positions in Pakistan and the Middle East with US and regional banks. Mr. Hoti holds an MBA from UCLA Graduate School of Management and a B.Sc. in Economics and Management from New York University.

Scott A. Creswell - General Counsel and Company Secretary

Mr. Creswell joined DMI Switzerland in 1986, and for ten years he was senior legal counsel in the legal department. Since 1997 he has been based in the Kingdom of Bahrain and is currently the head of the legal department at Ithmaar Bank B.S.C. Prior to joining DMI, Mr. Creswell practiced law in Chicago, Illinois and is currently admitted to practice before a number of courts, including the Illinois Supreme Court and the United States Supreme Court.

Maysan Al-Maskati – Executive Director Private Equity

Prior to joining Ithmaar Bank, Mr. Al-Maskati worked at Gulf One Investment Bank, where he was Vice President-Infrastructure, and Masar Advisory, where he held the position of Private Equity Director. He began his investment banking career in 1998 working for a leading financial institution, Emerging Markets Partnership (EMP), the General Partner and Manager of the US$930.5 million Islamic Development Bank (IDB) Infrastructure Fund. During his 4-year tenure with EMP, he served as Investment Officer, with responsibility for evaluating potential projects and was closely associated with the marketing and legal documentation of the Infrastructure Fund. Mr. Al-Maskati holds a B.Sc. in Industrial and Manufacturing Systems Engineering from Kansas State University, USA, and the Chartered Financial Analyst (CFA) Program.

Michael McKinlay – Executive Director Private Equity

Prior to joining Ithmaar Bank, Mr. McKinlay founded and led Stormberg Partners WLL, a GCC based advisory firm directed at the Chairmen and CEOs of leading Family Groups in the GCC. Before that, Mr. McKinlay had spent 15 years in wealth management 'start ups', working *inter alia* for Credit Suisse and HSBC establishing operations in KSA, Switzerland, Jersey and the UAE . He also served 10 years as a transactional commercial banker with JP Morgan in positions of country leadership. Mr. McKinlay has 20 years experience in the GCC dealing with investors from a range of asset classes. He has an MBA from Cranfield School of Management and is an Alumnus of the London Business School's Investment Management Programme.

Jassim Abdul Karim Salman – Executive Director IT & Operations

Mr. Salman is a seasoned Senior Manager. Before joining Ithmaar Bank, he was a Senior Advisor on IT & Operations to the Director General of the Dubai Financial Markets (DFM). He also contributed to the Bahrain capital markets industry, with extensive responsibilities for the planning and operations of the Bahrain Central Securities Depository, the management of Advanced Trading, Clearing and Settlement systems, as well as the practical management of IT functions at the Bahrain Stock Exchange (BSE). Other areas of experience include 15 years in HSBC as Manager Services reporting directly to the CEO. Mr. Salman is an electrical and electronic engineer with a vast working experience in the UK.

"It takes dedication to achieve perfection"

Nayla A. Asgharali - Director Compliance

Prior to joining the Bank, Mrs. Asgharali was the Head of Compliance, MLRO & Head of Operational Risk in Bank Muscat International and Head of Internal Audit for Futurebank. She has also worked for Bahrain Saudi Bank, where she served as a senior officer in the Internal Audit department. Before joining the Central Bank of Bahrain in 2004 as Bank Analyst in the Banking Supervision Directorate, she worked in Ernst & Young, as an internal auditor, for 3 years. Mrs. Asgharali is a Certified Financial Services Auditor (CFSA) and a Certified Internal Auditor (CIA). Mrs. Asgharali has a Bachelors of Science (B.Sc) from the University of Bahrain and recently acquired the Certified Anti-Money Laundering Specialist (CAMS) designation.

Management's Review of Operations

As an aggressive, growth-oriented institution, Ithmaar Bank is pursuing opportunities across geographic boundaries and business sectors. From China in the Far East, to our home markets in the Middle East & North Africa region (MENA), to the tried and tested European financial scene, Ithmaar Bank understands the need to maintain a balanced portfolio in an ever-changing world.

Products and Services

Ithmaar Bank's direct activities comprise the following:

-Underwriting Business (equity & debt)

-Private Equity (structuring, participation and portfolio management)

-Advisory Services (capital market, mergers & acquisitions and projects)

-Project Financing

Subsidiaries & Affiliates

Throughout 2006, Ithmaar Bank's subsidiaries and affiliates played a major role in contributing towards acheiving our strategic objectives and financial results.

Shamil Bank of Bahrain

Shamil Bank performed very well in 2006, achieving a net income of US$61.6 million, up 57 per cent over the US$39.1 million of the previous year. Total assets rose by 11 per cent to US$1,693 million at the end of 2006, compared with US$1,526 million at the same in 2005.

During the year, Shamil Bank was assigned a 'BBB-' long-term and 'A-3' short term counterparty rating with a 'stable outlook' by Standard & Poor's while Capital Intelligence upgraded its long term foreign currency and financial strength rating to 'BBB' from 'BBB-' with a 'stable outlook' maintained.

Shamil Bank is a leading Islamic commercial and investment bank based in the Kingdom of Bahrain, which provides a diverse range of products and services that cater to the financing and investment needs of individuals and institutions. It conducts its business in compliance with the principles of the Islamic Sharia, and is a full service Islamic investment bank, with a paid-up capital of US$230 million.

Shamil Bank operates a network of local branches and maintains a presence in overseas markets through its subsidiary, associated and affiliated companies. The Bank's shares are listed on the Bahrain Stock Exchange.

Senior Management:

Mohamed Hussain - Chief Executive Officer

Ahmed A. Rahim - General Manager, Support Group

Khaled Hassan El-Ruby - General Manager, Commercial Banking Group

Website: www.shamilbank.net

Faysal Bank Limited (Pakistan) - (FBL)

It was a year of expansion for Faysal Bank Limited in 2006, with the opening of 19 new branches, bringing its total number to 75. The bank also moved its head office to the newly built Faysal House in Karachi in June, while its central region office also moved to new purpose-built premises in Lahore towards the end of the year. The new branches brought increased operating expenses, so did the implementation of the first phase of a new core banking system that is expected to be fully in place by the end of 2007.

"Our projects add value not only to our investors, but to the society around it"

The net profit of FBL, in which Ithmaar now has a 51% equity interest, rose to US$54.6 million at December-end 2006, while its contribution to Ithmaar's profits increased by 31%.

Faysal Bank Limited started operations in Pakistan in 1987 as a branch of Faysal Islamic Bank of Bahrain and became a locally incorporated Pakistani bank in 1995 under its present name. Faysal Bank Limited is a full service banking institution offering consumer, corporate and investment banking facilities to its customers. A widespread and growing network of branches in the main provinces of the country and Azad Kashmir, together with its corporate offices, serve an ever growing customer base.

Senior Management:

Farook Bengali – President & CEO

Khalid Tirmizey – Deputy CEO

Ajaz Rahim – Country Head of Investment Banking

Website: www.faysalbank.com

Faisal Private Bank (Switzerland) S.A. - (FPB)

One of the main highlights of the year was the Swiss Federal Banking Commission's awarding of a full banking license to FPB in October 2006. Delivering an innovative platform for international clients, FPB is now equipped to handle the wide range of constantly shifting variables which shape today's global financial scene.

Faisal Private Bank S.A., in which Ithmaar holds a 79% interest, managed to offset rising expenses and a reduced profit share in managed funds, posting net profits of US$7.6 million at the end of 2006.

The Bank's established track record in tailoring innovative wealth management portfolios – principally in global real estate - forms the backbone of a strategy focused on engineering solutions that minimize the impact of corporate risk. In the future, Faisal Private Bank plans to diversify its products and services, and to sustain a prudent attitude towards risks and market volatilities, while delivering honest returns. FPB is founded on a unique business model to cater to the long term financial well-being of clients with unique wealth management needs, while staying within the boundaries of ethical principles derived from the Sharia. The Bank has a diverse international clientele comprising both institutions and private clients and is active in international real estate, equities, currencies and alternative asset classes through a specialist portfolio offering. Situated in Geneva, the bank is fully regulated and supervised by the Swiss Federal Banking Commission.

Senior Management

Marco Rochat – CEO

Alexander Theocharides – Head of Private Banking

Website: www.faisalprivatebank.com

Solidarity

In 2006 Ithmaar Bank invested a total of US$20 million following a 1:2 rights issue maintaining the Bank's interest at 40%. Solidarity continued to expand its range of products and client base, as reflected in its increased revenues over 2005. Costs were contained, resulting in a net profit for 2006 of US$5.4 million, compared to US$347,000 for 2005. The gross revenue was US$15.2 million in 2006, registering an increase of 47% against US$10.3 million in 2005.

The Company is set to capitalize on the success of the last few years by continuing its growth in key international markets. To strengthen its current position and achieve its expansion strategy, Solidarity is in the process of increasing its paid-up capital and is one of the largest Takaful companies in the world, providing products that comply with Islamic Sharia across the globe. It has the resources to deliver unmatched risk management financial solutions, tailored to meet different market needs.

"Breaking new ground in Banking"

Senior Management:

Sameer Ebrahim Alwazzan - Chief Executive Officer

Ashraf Adnan Bseisu - General Manager

Website: www.solidarity.cc

First Leasing Bank - (FLB)

In November 2006, First Leasing Bank issued a private placement offer of US$89 million shares, raising its capital to its current US$100 million. Ithmaar Bank acquired 21.3% of the issued capital for a total consideration of US$22.4 million. At the end of 2006 FLB's capital base stood at US$96.29 million (net of start-up expenses, operating expenses and share premium). The strong response to the private placement reflects investor endorsement of the strategy of FLB, which is the first bank headquartered in the Kingdom of Bahrain dedicated exclusively to heavy equipment and machinery leasing throughout the GCC.

Income generated from financial activities showed substantial growth over the previous year, increasing more than three-fold from US$260,000 to US$910,000 in 2006. Total operating income doubled to US$1.44 million, compared to US$730,000, with 90% of the income generated from core leasing activities. By the end of 2006 FLB had already secured US$8 million in signed commitments, with US$30 million worth of expected deals waiting in the pipeline.

FLB was established in 2004 with a paid-up capital of US$11 million. The equipment it leases covers, among others, the industrial, transportation, printing, power generation, construction and telecommunications sectors. With years of experience and business know-how, FLB provides a range of specialized services in the fields of business management, leasing and investment, industrial, manufacturing solutions, medicine, printing & publishing, telecommunications, IT, transportation, and marine amongst others.

Senior Management:

James A. Cracco – Chief Executive Officer

Ali Al-Sharaf – Finance and Administration Director

Agnel Pereira – Operations Director

Website: www.1stleasingbank.com

Investments

Ithmaar Bank, has identified and secured several major investment opportunities in 2006, including acquisitions, funds and real estate developments, which will contribute directly to strengthening the Bank's consolidated earnings.

The Bank, through its fully owned subsidiary Ithmaar Development Company, has a series of major real estate developments in the pipeline for 2007. Amongst these are the US$1 billion Health Island which will provide state-of-the-art healthcare and wellness facilities in a resort-type environment.

The US$175 million Serai project, in the Seef District, will consist of two twin towers, including a luxury Middle-Eastern themed family hotel and an office building. Partnering with Abraaj Capital, the Bank also intends to establish a chain of three other hotels in the Kingdom of Bahrain under the Serai-brand, namely the five-star resort Grand Serai, the five-star City Hotel Serai, and the four-star City Hotel Caravan Serai.

Human Resources and Infrastructure

During 2006 the Bank invested heavily in several key areas of operation with the objective of building its internal infrastructure and capabilities. Key managerial positions were covered by recruiting Managing Directors, Executive Directors and senior staff in areas such as Private Banking, Investments, IT & Operations, Private Equity, Compliance and Legal.

Following its ambitious long term plans and objectives, the Bank is in the process of moving into brand new offices, covering three floors in the Addex Tower in the Seef District. The new office features top-of-the-line IT infrastructure and internal control systems that will enable the Bank to continue growing steadily and incorporating new lines of business into its already diversified portfolio.

Ithmaar Bank's Shareholder Breakdown

Number of Shares	Shareholders
1 - 10,000	2,657
10,001 - 100,000	249
100,001 - 1,000,000	119
1,000,001 - 10,000,000	46
Over 10,000,000	1
TOTAL	3,072

Corporate Governance

CORPORATE GOVERNANCE

The Bank is committed to upholding the highest standards of corporate governance, which it regards as a key factor in ensuring fairness for all stakeholders and achieving organizational efficiency. During 2006, the Board conducted a thorough review of the Bank's high level policies for corporate governance, internal controls, risk management and compliance, in accordance with the latest regulations and guidelines issued by the Central Bank of Bahrain (CBB). The Board's adherence to best corporate governance practices is underlined by various principles, such as integrity, transparency, independence, accountability, responsibility, fairness and social responsibility.

Moreover, the Bank's Corporate Governance Policies are designed to lay a solid foundation for management and oversight, promote ethical and responsible decision making, safeguard integrity in financial reporting, make timely and balanced disclosures, respect the rights of shareholders, recognize and manage risk, encourage enhanced performance, remunerate fairly and responsibly, and recognize the legitimate interest of stakeholders.

Shareholder's Rights

Recognizing the importance of shareholders, Ithmaar Bank treats all its shareholders equally and fairly in line with the guidelines of regulatory agencies. Basic legitimate rights of shareholders include the right to participate in shareholders meetings, the right to appoint other persons as a proxy for participating in and voting at meetings, and the right to participate in the election or disqualification of a Director, individually. Their rights also include voting on the annual audit fees and appointments of independent auditors, and voting for other businesses of the Bank, such as increases in, or reduction of capital, right to receive dividend payments, as well as the right to give opinions and the right to enquire during shareholders meeting.

Bank Administration

The Bank is administered by the Board of Directors, Committees of the Board, and the Management Team.

Bank Administrative Chart

Board's Responsibilities

The Board of Directors is accountable to the shareholders for setting the broad policy guidelines and strategic direction, and the creation and delivery of strong sustainable financial performance and long-term shareholder value. The Chairman is responsible for leading the Board, ensuring its effectiveness, monitoring the performance and supporting the Executive Management. The Board's role includes the task of monitoring management in such a manner as to ensure that appropriate policies and processes are in place, that they are operating effectively and that the Bank is meeting its plans and budget targets.

Term

Each director is elected for a three-year term renewable at annual general meetings of the shareholders of the Bank.

Board Committees

The Board of Directors may, from time to time, establish committees as it considers necessary or appropriate to assist it in carrying out its responsibilities. The Board has established the following committees and has adopted charters setting out the matters relevant to their composition, responsibilities and administration.

Executive Committee

The main objective of this committee is to provide oversight of the company's strategic planning, approve transactions for which the Board has delegated authority to the committee within the parameters of the limits of authority, to make recommendations to the Board regarding transactions not falling within the limits of authority of the Executive Committee, and to evaluate the company's financial strategies and policies.

Mr. Khalid Abdulla-Janahi, Chairman

Mr. Graham R. Walker, Member

Mr. Michael P. Lee, Member (as of 1 January 2007)

Audit Committee

The Audit Committee comprises 3 members from the Board of Directors and operates under the terms of reference set forth in a formal charter. The Audit Committee assists the Board through review of the Bank's financial information, internal controls, risk management processes and internal audit functions. The Committee also oversees the internal audit function and evaluates the performance of the Bank's external auditors. In addition, the Committee is charged with ensuring the Bank's compliance with applicable laws and regulations.

Mr. Ziad H. Rawashdeh, Chairman

Mr. Abdelhameed Aboumoussa, Member

Mr. Khalil Nooruddin, Member

Remuneration and Nomination Committee

The main objective of this committee is to assist the Board in the effective discharge of its responsibilities in relation to the remuneration of directors and performance of the Board, ensure the appropriate board composition, ensure appropriate nomination of directors to the Board, and provide a formal forum for communication between the Board and the company's management on Human Resource issues.

Tunku Dato' Ya'acob Bin Tunku Abdullah, Chairman

Mr. Mohamed Bin Saif Al Mezrouei, Member

Sheikha Hissah Bint Saad Al-Sabah, Member

Insider Trading Compliance Sub-Committee (of the Executive Committee)

This Committee is established by the Executive Committee and its main objective is to undertake the responsibility of ensuring that the company complies with the insider trading guidelines issued by the Central Bank of Bahrain and to review and investigate any matter within the scope of its charter, and to make recommendations to the Executive Committee in relation thereto.

Mr. Graham R. Walker, Chairman

Mr. Asfar A. Mirza, Member

Mr. Jassim A. Karim Salman, Member

Executive Management

Management is responsible for operating the Bank in an effective, ethical and legal manner designed to produce value for the

Bank's shareholders consistent with the Bank's policies and standards. The Chief Executive Officer is appointed by and reports to the Board of Directors. Senior management is responsible for implementing the Board's strategic directions, and understanding the Bank's income-producing activities and material risks faced by the Bank.

Investment Committee (Management)

The main objective of this committee is to review, approve and ratify all investments within its authority, review risk management reports and resolve all credit-related issues.

Mr. Michael P. Lee, Chairman (as of 1 January 2007)

Sheikh Salman bin Ahmed Al Khalifa, Member

Mr. Mohamed Khan Hoti, Member

Board and Management Conduct

Confidentiality of Information

In order to facilitate open discussion, the Board believes that maintaining confidentiality of the Bank's information and Board and committee deliberations are critical.

Conflicts of Interest

Directors avoid any action, position or interest that conflicts with an interest of the Bank, or gives the appearance of a conflict. The Bank annually solicits information from directors in order to monitor potential conflicts of interest and directors are expected to be mindful of their fiduciary obligations to the bank. In the event of a situation involving a potential conflict of interest, directors are encouraged to seek advice from the Bank's compliance officer.

Code of Business Conduct and Ethics

The Bank's Code of Business Conduct and Ethics applies to members of the Board, as well as executive management, officers, employees, agents, consultants, and others, when they are representing or acting for the Bank. The Board of Directors, as well as officers and employees, act ethically at all times and acknowledge their adherence to the Bank's policies. Any waiver of the Code of Business Conduct and Ethics for a director or executive officer may be granted only by the Board or the appropriate Board committee and must be promptly disclosed to the stockholders.

Communication with Shareholders

The Bank conducts all communications with its stakeholders in a professional, honest, transparent, understandable, accurate and timely manner. Main communications channels include an annual report, quarterly publications of financial results, corporate website and regular announcements in the appropriate media.

Internal Audit

The Bank's internal audit function monitors compliance with the policies and procedures and effectiveness of internal controls. The work of internal audit is focused on the areas of risk assigned through a risk assessment approach.

The internal audit function reports directly to the Audit Committee of the Board of Directors. The internal auditors conduct their work independently of the Bank's senior management in accordance with the internal audit plan approved by the Audit Committee.

Compliance

The Bank conducts its business in conformity with all laws and regulations pertaining to financial institutions. Some of the important regulations which the Bank complies with include: Sharia Compliance, Legal Compliance including Commercial Companies and Labour laws, International Financial Reporting Standards, Basel II Accord – in process, and Central Bank of Bahrain's regulations and guidelines. To promote a sound internal control framework by ensuring that all banking business is conducted in compliance with applicable laws and regulations as well as internal policies and procedures, the Bank has appointed a full-time compliance officer.

> “Ithmaar aims to capture its investors’ imagination”

Director's Report

For the year ended 31 December 2006

The Directors have pleasure in submitting their report together with the audited consolidated financial statements for the year ended 31 December 2006.

Consolidated financial statements

The consolidated financial statements, which can be found on pages 37 to 96, have been prepared incorporating the financial statements of Ithmaar Bank B.S.C. (the "Bank") and its subsidiaries (collectively the "Group").

Principal activity

The Bank carries on the business of investment banking in accordance with the terms of its licence issued by the Central Bank of Bahrain. The principal activities of the Group are a wide range of financial services.

Private placement and initial public offering

In December 2005, the Bank offered 50,000,000 new shares through a fully underwritten issue to existing unit holders and certain employees of Dar Al-Maal Al-Islami Trust through a private placement. This offer was subsequently increased to 60,000,000 shares. These shares were offered at $1.00 per share and were subject to the same rights and obligations as applicable to other shares in the Bank apart from the entitlement to dividends in respect of the year ended 31 December 2005. The shares offered through the private placement were allotted on the closing of the initial public offering.

The Bank offered 150,000,000 new shares through an initial public offering in March 2006 at a price of $2.25 per share. Following the successful completion of the private placement and the initial public offering, the Bank's issued and paid up capital was increased to $360 million and the Bank was reconstituted as a Bahraini Public Shareholding Company according to the provisions of the Commercial Companies Law (Decree No. 21 of 2001) with Commercial Registration No. 15210 and was renamed Ithmaar Bank B.S.C.

"Ouverture au Monde" Sculpture
by Angelo Duarte,
Ouchy Lausanne, Switzerland.

Financial position

The full results for the year ended 31 December 2006 and the financial position of the Group as at that date are set out in the accompanying financial statements. In summary, the Bank reported a consolidated net profit, attributable to the Bank's equity shareholders, of $168.2 million, compared with $36.5 million for 2005. At the year-end, total assets stood at $3.2 billion (2005: $442 million), in addition to which the Group had funds under management of $1.1 billion (2005: $1.5 billion. The Bank's shareholders' equity amounted to $758.5 million (2005: $247.4 million).

Dividend

The Directors propose to recommend at the Annual General Meeting a payment of dividend of 13.5 cents per share for the year ended 31 December 2006 equivalent to a total payment of $47,725,860 (2005: $20,000,000).

Appropriations

On the basis of the results of the Bank for the year ended 31 December 2006, the Board of Directors recommends the following appropriations of the Bank's net profit for approval by the shareholders:

	US$
Transfer to statutory reserve	16,820,000
Proposed cash dividend	47,725,860
Transfer to retained earnings	130,058,000

Directors

The following Directors served during the year ended 31 December 2006 and to the date of this report:

Mr. Khalid Abdulla-Janahi (Chairman)	
Tunku Dato' Ya'acob Bin Tunku Abdullah	appointed on 3 May 2006
Mr. Abdel Hamid Abo Moussa	appointed on 3 May 2006
Mr. Mohamed Bin Saif Al Mezrouei	appointed on 3 May 2006

Mr. Farook Bengali	appointed on 3 May 2006	
Mr. Mohammed Bucheerei		resigned on 3 May 2006
Mr. Mohammed Youseef El-Khereiji	appointed on 3 May 2006	
Sheikha Hanadi Nasser Bin Khalid Al-Thani	appointed on 3 May 2006	resigned on 6 September 2006
Sheikha Hissah Bint Saad Al-Sabah	appointed on 3 May 2006	
Mr. Khalil Nooruddin	appointed on 3 May 2006	
Mr. Ziad H. Rawashdeh		
Mr. Graham R. Walker		

Directors and executive management held 4,929,866 shares in the Bank as at 31 December 2006 (2005: nil). Directors' fees in respect of 2006 amounted to $806,500 (2005: nil).

Auditors

The auditors, PricewaterhouseCoopers, have expressed their willingness to continue in office and a resolution proposing their reappointment will be placed before the Annual General Meeting.

Acknowledgements

The Directors, on behalf of the shareholders, take this opportunity to express their gratitude and appreciation to His Majesty King Hamad Bin Isa Al-Khalifa, the King of Bahrain, to His Highness Sheikh Khalifa Bin Salman Al-Khalifa, the Prime Minister, to His Highness Sheikh Salman Bin Hamad Al-Khalifa, the Crown Prince and Commander-in Chief of the Bahrain Defence Force and to all Government ministries and institutions, especially the Ministry of Finance and the Central Bank of Bahrain for their kind consideration and support.

The Directors also extend their thanks to the Bank's valued customers and shareholders for their continued support and confidence and to all the staff of the Group for their commitment and dedication.

By order of the Board of Directors

Khalid Abdulla-Janahi
Chairman

Graham R. Walker
Director

26 February 2007

Consolidated Financial Statements 2006

Index to the Consolidated Financial Statements

Independent Auditors' Report

To The Shareholders of Ithmaar Bank B.S.C.

Report on the financial statements

We have audited the accompanying consolidated financial statements of Ithmaar Bank B.S.C. (the "Bank") and its subsidiaries (together, the "Group"), which comprise the consolidated balance sheet as at 31 December 2006, the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2006, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on regulatory requirements

Further, as required by the Bahrain Commercial Companies Law (“BCCL”) and the Central Bank of Bahrain Law (“CBBL”) , we report that we have obtained all the information that we considered necessary for the purpose of our audit; the Bank has maintained proper books of account and the consolidated financial statements and the financial information contained in the Directors’ report are in agreement therewith; and nothing has come to our attention which causes us to believe that the Bank has breached any of the applicable provisions of the BCCL, the CBBL, the terms of its banking license or its Memorandum and Articles of Association which would materially affect its activities or its financial position as at 31 December 2006.

Manama, Kingdom of Bahrain

26 February 2007

Consolidated Balance Sheet

as at 31 December

(Thousands of US dollars)

	Notes	2006	2005
Assets			
Cash and cash equivalents		619,977	25,536
Due from banks		1,900	139
Trading securities	6	394	211
Derivative financial instruments	7	155	-
Investments in financings	8	1,635,035	99,795
Investment securities	9	403,090	35,553
Investment property	10	67,766	43,769
Accounts receivable	11	65,747	77,029
Investments in associates	12	152,520	157,451
Property, plant and equipment	13	30,701	2,334
Intangible assets	14	200,497	531
Non-current assets held for sale	15	2,156	-
Total assets		**3,179,938**	**442,348**
Liabilities			
Customer current accounts		383,704	-
Customer investment accounts		1,051,871	5,062
Due to banks		535,967	6,005
Investments from off balance sheet funds	30	5,002	119,295
Derivative financial instruments	7	293	-
Accounts payable	16	172,570	55,902
Current tax payable		9,623	220
Deferred tax liability	17	36,070	3,087
Total liabilities		**2,195,100**	**189,571**
Equity			
Capital and reserves attributable to the Bank's equity holders			
Share capital	27	353,525	150,000
Reserves		404,966	97,359
		758,491	**247,359**
Minority interests	26	**226,347**	**5,418**
Total equity		**984,838**	**252,777**
Total equity and liabilities		**3,179,938**	**442,348**

These consolidated financial statements were approved for issue by the Board of Directors on 26 February 2007 and signed on their behalf by:

Khalid Abdulla-Janahi
Chairman

Graham Walker
Director

The notes on pages 47 to 96 form an integral part of these consolidated financial statements.

Consolidated Statement of Income

for the year ended 31 December

(Thousands of US dollars)

	Notes	2006	2005
Income			
Fund management and services	30	43,283	24,775
Income from short term deposits		23,144	1,471
Net trading income	18	1,587	-
Income from investments in financings	19	56,631	2,073
Gains less losses from investment securities	9	(1,201)	268
Fee and commission income	20	27,729	9,174
Dividend income	21	825	-
Other income	22	15,620	8,304
		167,618	46,065
Distribution to investment account holders		(47,984)	(3,011)
Operating income		119,634	43,054
Expenses			
Staff costs	23	28,066	20,611
General and administrative expenses		17,319	8,311
Depreciation and amortisation	13, 14	4,103	677
Exchange (gain)/loss		100	(39)
Total expenses		49,588	29,560
Operating profit		70,046	13,494
Share of net profit of associated companies	12	15,695	20,487
Gain on sale of subsidiary	33	105,541	-
Gain on sale of associated company	33	4,613	4,597
Profit before income taxes		195,895	38,578
Taxes	25	(12,125)	(1,002)
Profit after income taxes		**183,770**	**37,576**
Attributable to:			
Equity holders of the Bank		168,200	36,533
Minority interests	26	15,570	1,043
		183,770	**37,576**
Basic/diluted earnings per share	28	US cts 55	US cts 24

These consolidated financial statements were approved for issue by the Board of Directors on 26 February 2007 and signed on their behalf by:

Khalid Abdulla-Janahi
Chairman

Graham Walker
Director

The notes on pages 47 to 96 form an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

for the year ended 31 December

(Thousands of US dollars)

		--------------- Attributable to the Bank's equity holders					-----------------			
	Notes	Share capital	Statutory reserve	General reserve	Fair value reserve	Currency translation	Retained earnings	Total reserves	Minority interests	Total equity
At 1 January 2006		150,000	8,778	13,503	24,678	(7,756)	58,156	97,359	5,418	252,777
New issue of ordinary shares	29	210,000	187,500					187,500		397,500
Treasury shares acquired	27	(6,475)	(6,510)					(6,510)		(12,985)
Share issue expenses			(14,672)	826				(13,846)		(13,846)
Share based payments			1,029					1,029		1,029
Net profit for the year							168,200	168,200	15,570	183,770
Dividend declared	24						(20,000)	(20,000)	(13,839)	(33,839)
Change of ownership interest in subsidiary				(3,910)	(184)	(235)	(1,322)	(5,651)	221,375	215,724
Movement in fair value of available-for-sale investments					(614)			(614)	(1,224)	(1,838)
Movement in deferred tax available-for-sale investments					(2)			(2)	(1)	(3)
Movement in fair value of associated companies				1,381	(5,546)			(4,165)	(21)	(4,186)
Associated companies sold					(2,212)	3,211		999		999
Available-for-sale investments sold					31			31	2	33
Foreign currency translation adjustment						636		636	(933)	(297)
Transfer to statutory reserve			16,820				(16,820)			
At 31 December 2006		353,525	192,945	11,800	16,151	(4,144)	188,214	404,966	226,347	984,838

The notes on pages 47 to 96 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December

(Thousands of US dollars)

		---- Attributable to the Bank's equity holders ----								
	Notes	Share capital	Statutory reserve	General reserve	Fair value reserve	Currency translation	Retained earnings	Total reserves	Minority interests	Total equity
At 1 January 2005		150,000	5,124	14,327	11,446	(1,826)	35,462	64,533	4,730	219,263
Net profit for the year							36,533	36,533	1,043	37,576
Dividend declared	24						(10,000)	(10,000)	(750)	(10,750)
Movement in fair value of available-for-sale investments					1,504			1,504	497	2,001
Movement in fair value of associated companies	12				12,048		(185)	11,863		11,863
Available-for-sale investments sold					(320)			(320)	(106)	(426)
Share issue expenses	29			(826)				(826)		(826)
Foreign currency translation adjustment				2		(5,930)		(5,928)	4	(5,924)
Transfer to statutory reserve			3,654				(3,654)			
At 31 December 2005		150,000	8,778	13,503	24,678	(7,756)	58,156	97,359	5,418	252,777

The notes on pages 47 to 96 form an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows

for the year ended 31 December

(Thousands of US dollars)

	Notes	2006	2005
Cash flows from operating activities			
Profit before taxes and minority interests		195,895	38,578
Adjustments for:			
Share based payments		1,029	-
Depreciation and amortisation	13,14	4,102	677
Change in fair value of investment properties	10	(13,205)	1,002
Gain on sale of subsidiary	33	(105,541)	-
Income from associated companies	12	(20,308)	(25,084)
Operating profit before changes in operating assets and liabilities		61,972	15,173
(Increase)/decrease in due from financial institutions		(1,840)	209
Net increase in derivative financial instruments		(80)	-
Net decrease/(increase) of trading securities		(196)	518
(Increase)/decrease in investments in financings		(182,048)	406
Decrease of investment securities		166,700	4,454
Decrease in accounts receivable		74,257	5,110
(Decrease) in accounts payable, excluding taxes		(28,432)	(9,484)
(Decrease) in investment accounts		(176,640)	(16,313)
Taxes refunded/(paid)		1,435	(1,210)
Net cash (used) by operating activities		(84,872)	(1,137)
Cash flows from investing activities			
Cash inflow on sale of a subsidiary	33	134,376	-
Cash inflow on purchase of a subsidiary	33	22,447	-
Cash inflow on conversion of associate to subsidiary	33	233,899	-
Dividends from associated companies	12	4,596	6,864
Net purchase of associated companies	12	(53,030)	-
Net purchase of investment property	10	(190)	(1,364)
Acquisition of property, plant and equipment and intangibles	13,14	(3,404)	(376)
Acquisition of non-current assets held for sale		(530)	-
Net cash provided by investing activities		338,164	5,124

Consolidated Statement of Cash Flows

for the year ended 31 December (continued)

(Thousands of US dollars)

	Notes	2006	2005
Cash flows from financing activities			
Treasury shares purchased	27	(12,985)	-
Dividends paid	24	(20,000)	(10,000)
Dividends paid to minority shareholders of subsidiaries		(13,839)	(750)
Proceeds from issuance of shares	29	397,500	-
Proceeds from issuance of shares in subsidiaries		1,434	-
Share issue expenses paid	29	(14,671)	-
Net cash provided/(used) by financing activities		337,439	(10,750)
Foreign currency translation adjustments		3,710	1,437
Net increase/(decrease) in cash and cash equivalents		**594,441**	**(5,326)**
Cash and cash equivalents at beginning of period		25,536	30,862
Cash and cash equivalents at end of period		**619,977**	**25,536**

The notes on pages 47 to 96 form an integral part of these consolidated financial statements.

1. Formation and activities

Ithmaar Bank B.S.C. (the "Bank") was incorporated in the Kingdom of Bahrain on 13 August 1984 and is an investment bank regulated by the Central Bank of Bahrain (formerly Bahrain Monetary Agency). The Bank has its registered office at Seef Tower, 14th floor, Al Seef District, Manama, Kingdom of Bahrain.

The principal activities of the Bank and its subsidiaries (collectively the "Group") are a wide range of financial services, including the management of Islamic modarabas which are similar to investment funds. The modarabas are not consolidated in the accompanying financial statements because they represent funds invested by clients without recourse to the Group. Accordingly, they are included in off-balance sheet accounts as disclosed in note 30.

During the first six months of 2006, the Bank's issued share capital was increased to $360 million. As a result, Dar Al-Maal Al-Islami Trust, a Trust formed by indenture under the laws of the Commonwealth of the Bahamas, reduced its ownership of the Bank from 100% to 42%. Public trading of Ithmaar Bank B.S.C. shares (ITHMR) began on the Bahrain Stock Exchange on 4 June 2006.

2. Accounting policies

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of preparation

The consolidated financial statements of the Group are prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Interpretations Committee (IFRIC) interpretations. The consolidated financial statements are prepared under the historical cost convention as modified by the revaluation of available-for-sale financial assets, financial assets and financial liabilities held at fair value through profit or loss and investment property.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

Impact of New Accounting Pronouncements: International Financial Reporting Standards

Amendments to published standards effective in 2006

The following amendments to published standards are mandatory for the Group's accounting periods beginning on or after 1 January 2006:

2. Accounting policies (continued)

IAS 19 (Amendment), Employee Benefits, is mandatory for the Group's accounting periods beginning on or after 1 January 2006. It introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. As the Group does not intend to change the accounting policy adopted for recognition of actuarial gains and losses and does not participate in any multi-employer plans, adoption of this amendment only impacts the format and extent of disclosures presented in the accounts.

IAS 39 (Amendment), The Fair Value Option. This amendment restricts the possibility for the Group to designate financial instruments at fair value through profit and loss that are not held for trading or derivatives. The designation of an instrument to be at fair value is now possible when it removes or significantly reduces accounting mismatches in measurement or presentation, or where financial instruments are managed and their performance is evaluated on a fair value basis. The Group was able to continue to measure at fair value through profit and loss all financial instruments that it had previously designated at fair value through profit and loss because it met the conditions for designation.

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but are not relevant to the Group's operations:

IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions; IAS 39 (Amendment), The Fair Value Option; IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts; IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources; IFRS 6, Exploration for and Evaluation of Mineral Resources; IFRIC 4, Determining whether an Arrangement contains a Lease; and IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds. IFRIC 6, Liabilities arising from Participating in a Specific Market –Waste Electrical and Electronic Equipment.

New accounting standards and IFRIC interpretations that are not yet effective

The following new Standard and interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 May 2006 or later periods but that the Group has not early adopted:

IFRIC 8, Scope of IFRS 2 (effective for annual periods beginning on or after 1 May 2006). IFRIC 8 requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether or not they fall within the scope of IFRS 2. The Group will apply IFRIC 8 from 1 January 2007, but it is not expected to have any impact on the Group's accounts; and

2. Accounting policies (continued)

IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006). IFRIC 10 prohibits the impairment losses recognised in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. The Group will apply IFRIC 10 from 1 January 2007, but it is not expected to have any impact on the Group's accounts.

IFRS 7, Financial Instruments: Disclosures, and a complementary amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007). IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and disclosure requirements in IAS 32, Financial Instruments: Disclosure and Presentation. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital.

The Group assessed the impact of IFRS 7 and the amendment to IAS 1 and concluded that the main additional disclosures will be the sensitivity analyses to market risk and the capital disclosures required by the amendment of IAS 1. The Group will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning 1 January 2007.

The following interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 May 2006 or later periods but are not relevant for the Group's operations:

IFRIC 7, Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006). IFRIC 7 provides guidance on how to apply the requirements of IAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period. As none of the group entities have a currency of a hyperinflationary economy as its functional currency, IFRIC 7 is not relevant to the Group's operations; and IFRIC 9, Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006).

IFRIC 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. As none of the group entities have changed the terms of their contracts, IFRIC 9 is not relevant to the Group's operations.

2. Accounting policies (continued)

Consolidation

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date on which control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the consolidated statement of income.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Subsidiaries' accounting policies have been changed where necessary to ensure consistency with the policies adopted by the Group.

Costs associated with the restructuring of a subsidiary as a part of the acquisition or subsequent to the acquisition are included in the consolidated statement of income upon the date of commitment.

(b) Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition.

The Group's share of its associates' post-acquisition profits or losses is recognised in the consolidated statement of income, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

2. Accounting policies (continued)

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounts for associated companies have been restated to conform with Group accounting policies, if necessary, except as otherwise disclosed.

Where a subsidiary or an associated company is acquired and held exclusively with a view to its disposal within the next twelve months or where it can be clearly demonstrated control of a subsidiary or significant influence over an associated company does not exist, the subsidiary or associated company is classified as an investment security available-for-sale in the Group's consolidated financial statements.

Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those segments operating in other economic environments.

Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's subsidiaries are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in United States dollars, which is the Bank's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of income. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at the year end exchange rate of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of income, except where hedge accounting is applied.

Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of their fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the fair value reserve in equity.

2. Accounting policies (continued)

(c) Group companies

The results and financial position of all group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each statement of income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions);

(iii) and all resulting exchange differences are recognised as a separate component of equity (cumulative translation adjustment).

Exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity on consolidation. When a foreign operation is sold, such exchange differences are recognised in the consolidated statement of income as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

Derivative financial instruments and hedging

Derivative financial instruments including foreign exchange contracts, equity options and equity futures are initially recognised in the consolidated balance sheet at fair value and subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, discounted cash flow models, and options pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Changes in the fair value of derivatives held for trading are included in net trading income.

On the date a derivative contract is entered into, the Group designates derivatives as either (a) a hedge of fair value of a recognised asset or liability (fair value hedge); or (b) a hedge of highly probable future cash flows attributable to a recognised asset or liability, a forecast transaction or a firm commitment (cash flow hedge). At present the Group does not hedge future cash flows. Hedge accounting is used for derivatives provided certain criteria are met.

The Group's criteria for a derivative instrument to be accounted for as a hedge include:

(a) Formal documentation of the hedging instrument, hedged item, hedging objective, strategy and relationship is prepared before hedge accounting is applied; (b) the hedge is documented showing that it is expected to be highly effective in offsetting the risk in the hedged item through out the reporting period; and (c) the hedge is highly effective on an ongoing basis.

2. Accounting policies (continued)

Changes in the fair value of the effective portions of derivatives that are designated and qualify as fair value hedges and that prove to be highly effective in relation to hedged risk, are recorded in the consolidated statement of income, along with the corresponding change in fair value of the hedged asset or liability that is attributable to that specific hedged risk.

If the fair value hedge no longer meets the criteria for hedge accounting, an adjustment to the carrying amount of a hedged financial instrument is amortised in the consolidated statement of income over the period to maturity. The adjustment to the carrying amount of a hedged equity security remains in retained earnings until the disposal of the equity security.

Certain derivative transactions, while providing effective economic hedges under the Group's risk management policies, do not qualify for hedge accounting under the specific rules in IAS 39 and are therefore treated as derivatives held for trading with fair value gains and losses reported in the consolidated statement of income.

Income from investments and investments in financings

Income from investments and investments in financings, which is both contractually determined and quantifiable at the commencement of the transaction, is accrued on the effective return method basis over the period of the transaction. Where income is not contractually determined or quantifiable, it is recognised when reasonably certain of realisation or when realised. Income recognition is suspended when financings become doubtful of collection and recognised only when received.

Fees and commission income

Fees and commissions are generally recognised as income when earned. Origination fees on financings which are probable of being drawn down, are deferred and recognised over the term of the financing as an adjustment to the effective yield. Structuring fees, commission and fees arising from negotiating or participating in the negotiation of a transaction for a third party, are recognised on completion of the underlying transaction.

Asset management fees related to investment funds are recognised rateably over the period the service is provided and are recorded in fund management and services income.

Management advisory and technical service fees are recognised based on applicable service contracts usually on a time-apportionate basis and are recorded in other income.

Distribution to investment account holders

The expense charged to the consolidated statement of income as a distribution to investment account holders represents the share of the Group's income from all sources which is due to customers of the Group under contractual arrangements in force.

2. Accounting policies (continued)

Sale and repurchase agreements

Securities sold subject to a linked repurchase agreement are recognised as trading or investment securities and the counterparty liability is included in customer investment accounts. The difference in the sale and repurchase value is accrued over the period of the contract and recorded as expense in the consolidated statement of income.

Securities purchased under agreements to resell are recorded as investments in financings. The difference between the contracted price and the resale price is amortised over the period of the contract and is recognised as income in the consolidated statement of income.

Obligations for the return of securities or for forward sales, which are a part of the repurchase agreements, are recognised as commitments as disclosed in note 34.

Financial Assets

The Group classifies its financial assets into the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments and available-for-sale financial assets. The classification of investments is determined at initial recognition. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or when the Group has transferred substantially all risks and rewards of ownership.

(a) Financial assets at fair value through profit or loss

This category includes financial assets held for trading, including trading securities, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Such a designation, once made, is irrevocable. Derivatives are also categorised as held for trading unless qualifying for hedge accounting.

Financial assets at fair value through profit and loss are initially recognised at fair value (which excludes transaction costs) and subsequently carried at fair value based on quoted bid prices. All related realised and unrealised gains and losses are included in net trading income in the period in which they arise. Dividends declared are included in dividend income.

All purchases and sales of financial assets held for trading and at fair value through profit and loss that require delivery within the time frame established by regulation or market convention ('regular way' purchases and sales) are recognised at trade date, which is the date that the entity commits to purchase or sell the asset.

(b) Loans and receivables

Loans and receivables, which include investments in financings, are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no

2. Accounting policies (continued)

intention of trading the receivable. Loans and receivables are carried at amortised cost using the effective yield method. All loans are recognised when cash is advanced to the customer.

(c) Held-to-maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities and there is the intent and the ability to hold them to maturity. If more than an insignificant amount of held-to-maturity assets is sold, the entire category will be considered tainted and reclassified as available-for-sale.

Held-to-maturity investments are carried at amortised cost using the effective yield method, less any provision for impairment.

(d) Available-for-sale

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in exchange rates, equity prices or other market rates. All regular way purchases and sales of investment securities are recognised at trade date, which is the date that the entity commits to purchase or sell the asset.

Available-for-sale investments are initially recognised at fair value (which includes transaction costs) and subsequently carried at fair value. The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active or the asset is an unlisted security, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Unrealised gains and losses arising from changes in the fair value of securities classified as available-for-sale are recognised in equity. When the securities are disposed of or impaired, the related accumulated fair value adjustments are included in the consolidated statement of income as gains or losses from investment securities. Dividends declared are included in dividend income.

Impairment of Financial Assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired.

(a) Assets carried at amortised cost

A financial asset or a group of financial assets is impaired if and only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that event has an impact on the estimated future cash flows of the asset that can be reliably estimated. If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's

2. Accounting policies (continued)

carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective rate of return, including any amounts recoverable from guarantees and collateral, and recognised in the consolidated statement of income.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed through the consolidated statement of income.

In the case of Islamic financings to customers in countries where there is an increased risk of difficulties in servicing external debt, an assessment of the political and economic situation is made and additional country risk provisions may be established.

(b) Assets classified as available-for-sale

In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below their cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss, measured as the difference between the acquisition cost and the current fair value less any impairment loss on that financial asset previously recognised, is removed from equity and recognised in the consolidated statement of income. If in subsequent periods the fair value of equity instruments increases, impairment losses previously recognised in the consolidated statement of income are not reversed but are recognised in equity as adjustments to fair value.

Due from financial institutions

Due from banks comprises mainly short term deposits in the form of parallel purchase and sale of currencies and commodities (PPSC), which are spot purchases of internationally traded currencies and commodities and a corresponding forward sale of the same. For the purpose of accounting, these are treated as term deposits and the return is recorded as income from investments in the statement of income.

Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of associates is included in investments in associates. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing.

(b) Computer software

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives (three to five years).

2. Accounting policies (continued)

Costs associated with developing or maintaining computer software programs are recognised as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include software development employee costs and an appropriate portion of relevant overheads.

Computer software development costs recognised as assets are amortised using the straight line method over their useful lives.

(c) Other acquired intangible assets

Other acquired intangible assets determined to have finite lives, such as core deposits and customer relationships, are amortised over their estimated useful lives in a manner that best reflects the economic benefits of the intangible asset.

Investment property

Investment property principally comprises office buildings which are held to earn rental income or for long-term capital appreciation or both. Investment property is treated as a long-term investment and is carried at fair value, representing open market value determined annually by reference either to external valuers or to other independent valuation sources. Changes in fair values are recorded in the consolidated statement of income as part of other income. The Group does not classify operating leases as investment property.

Property, plant and equipment and depreciation

Property, plant and equipment are stated at historical cost less subsequent depreciation and impairment, except for land, which is shown at cost less impairment. Land is not depreciated. Cost includes expenditure that is directly attributable to the acquisition of the items.

Depreciation is calculated on the straight-line method to write off the cost of each asset over its estimated useful life as follows:

Buildings	50 years
Leasehold improvements	over the period of the lease
Furniture, equipment and motor vehicles	3-10 years

Depreciation is calculated separately for each significant part of an asset category. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount. The asset's residual value and useful life are reviewed, and adjusted if appropriate, at each balance sheet date.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost can be measured reliably. All other repairs and renewals are charged to the consolidated statement of income during the financial period in which they are incurred.

Gains and losses on disposal of property, plant and equipment are determined by comparing proceeds with carrying amounts.

2. Accounting policies (continued)

Leases

Total payments made under operating leases are charged to the consolidated statement of income on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

When a Group company is the lessee of property, plant and equipment and the Group has substantially all the risks and rewards of ownership, they are classified as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in payables. The profit element of the finance cost is charged to the consolidated statement of income over the lease period. The asset acquired under finance leases is depreciated over the shorter of the useful life of the asset or the lease term.

When a Group company is the lessor and assets are held subject to a finance lease, the value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the actuarial method.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate of the amount of the obligation can be made. Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the balance sheet date.

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long-service leave as a result of services rendered by employees up to the date of the consolidated balance sheet.

Non-current assets held for sale

The Group classifies a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. A non-current asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups). Its sale must be planned and committed and an active programme initiated to locate a buyer and complete the plan within one year. The asset (or disposal group) must be actively marketed for a price that is reasonable in relation to its current fair value.

2. Accounting policies (continued)

A non-current asset held for sale is carried at the lower of its carrying amount and the fair value less costs to sell. Impairment losses are recognised through the consolidated statement of income for any initial or subsequent write down of the asset (or disposal group) to fair value less costs to sell. Subsequent gains in fair value less costs to sell are recognised to the extent they do not exceed the cumulative impairment losses previously recorded. A non-current asset is not depreciated while classified as held for sale or while part of a disposal group held for sale.

The Group separately classifies the non-current assets held for sale (or disposal group) in the consolidated balance sheet. Furthermore, all major classes of assets and liabilities are disclosed. Any cumulative income or expense is disclosed as a separate item within equity. Prior period amounts are not re-presented to reflect the classification of the assets (or disposal group) in the current period.

Non-current assets, which are to be abandoned, are not classified as held for sale and are reclassified as discontinued operations, to the extent they meet the requirements of discontinued operations in the paragraph which follows.

If a non-current asset (or disposal group) ceases to be classified as held for sale or as discontinued operations, the results of operations are reclassified and included in the consolidated statement of income from continuing operations for all periods presented.

Discontinued Operations

A discontinued operation is a component (cash generating unit) of an entity that either has been disposed of or is classified as held for sale and a) represents a major business line or geographical area of operations; b) is part of a single coordinated plan to dispose of a separate major business line or geographical area of operations; or c) is a subsidiary acquired exclusively with a view to resell.

The Group presents after tax results from discontinued operations as a single separate component of the consolidated statement of income. Income, expenses, taxes, gains or losses on the measurement to fair value less costs to sell and cash flows are additionally disclosed. Prior periods are reclassified in order to present all operations that have been discontinued by the balance sheet date of the latest period presented.

Taxation

Taxes are provided and charged in the consolidated statement of income on the basis of the estimated tax expense payable currently and in future years, arising in respect of the results of current operations.

Deferred income taxes

Deferred income tax is provided, using the comprehensive liability method, for all temporary differences arising between the tax bases of assets and liabilities and their respective carrying values for financial reporting purposes. The amount of deferred taxes on these

2. Accounting policies (continued)

differences is determined using the provisions of local tax laws, including rates, and is adjusted upon enactment of changes in these laws. Provision is made for potential taxes which could arise on the remittance of retained overseas earnings where there is a current intention to remit such earnings.

A deferred tax asset is recognised for all deductible temporary differences and carry forward of unused tax losses and tax credits to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences and unused tax losses and tax credits can be utilised.

Deferred tax related to fair value re-measurement of investments available-for-sale which is charged or credited directly to the fair value reserve, is also credited or charged directly to the fair value reserve and is subsequently recognised in the consolidated statement of income together with the deferred gain or loss.

Retirement benefit plans

The Group operates a number of defined benefit and defined contribution pension plans throughout the world, the assets of which are generally held in separate trustee-administered funds. The pension plans are generally funded by payments from employees and by the relevant Group companies, taking into account the recommendations of independent qualified actuaries.

For defined benefit plans, the pension accounting costs are assessed using the projected unit credit method. Under this method, the cost of providing pensions is charged to the consolidated statement of income so as to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries who carry out a valuation of the plans every year. The pension obligation is measured as the present value of the estimated future cash outflows using standard financial cost rates which have terms to maturity approximating the terms of the related liability. Actuarial gains and losses arising from experience adjustments, and changes in actuarial assumptions, in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation, are charged or credited to income over the employees' expected average remaining working lives.

The Group's contributions to defined contribution pension plans are charged in the consolidated statement of income in the year to which they relate.

Share capital

Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds.

Dividends on share capital are recognised as an appropriation in equity in the period in which they are declared. Dividends for the year which are declared after the date of the statement of financial position are dealt with in note 24.

2. Accounting policies (continued)

Share-based payments

The Bank has adopted IFRS 2 Share-based Payments with respect to shares issued to employees at below fair value. As a result, the Bank has charged the cost of such payment, being the difference between the deemed fair value of the shares and the proceeds received, to the consolidated statement of income and credited this amount to the statutory reserve.

Treasury shares

Where any Group company purchases the Bank's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs is deducted from equity attributable to the Bank's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs is included in equity attributable to the Bank's equity holders.

Acceptances

Acceptances comprise undertakings by the Group to pay bills of exchange drawn on customers. The Group expects most acceptances to be settled simultaneously with the reimbursement from the customers. Acceptances are accounted for as off-balance sheet transactions and are disclosed as contingent liabilities and commitments.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks, loans and advances to banks and amounts due from other banks.

Fiduciary activities

The Group through its banking subsidiaries provides fund management and advisory services to third parties which involve the Group making allocation and purchase and sale decisions in relation to a wide range of financial instruments. Those assets that are held in a fiduciary capacity are not included in these financial statements.

Income arising from fund management and advisory services comprises the revenues earned from the management of the funds in the modarabas accrued on the basis of the terms and conditions of the related management agreements. Funds under management represent amounts invested by clients and placed with funds managed by the Group.

3. Financial risk management

a. Strategy in using financial instruments

By its nature, the Group's activities are principally related to the use of financial instruments. The Group accepts investments from customers at varying rates of return and for various periods and seeks to earn above average profits by investing these funds in high quality assets. The Group seeks to increase these margins by consolidating short-term funds and investing for longer periods at higher return potential whilst maintaining sufficient liquidity to meet all claims that might fall due.

The Group also seeks to raise its profit margins by obtaining above average margins, net of provisions, through transactions with commercial and retail customers. Such exposures involve not just on-balance sheet Islamic financings but the Group also enters into Islamically acceptable guarantees and other commitments such as letters of credit and performance and other bonds.

The Group also trades in financial instruments where it takes positions in traded and over the counter instruments including derivatives to take advantage of short-term market movements in the equity and bond markets and in currency and profit rates. The individual subsidiary's Boards place trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions. With the exception of specific hedging arrangements, foreign exchange and profit rate exposures associated with these derivatives are normally offset by entering into counterbalancing positions, thereby controlling the variability in the net cash amounts required to liquidate market positions.

The Group utilises the following derivative instruments for both hedging and non-hedging purposes:

(i) Currency forwards represent commitments to purchase foreign and domestic currency, including undelivered spot transactions; (ii) equity futures are contractual obligations to receive or sell shares on a future date at a specified price established in an organised financial market; and (iii) equity options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of shares at a predetermined price. In consideration for the assumption of the risk, the seller receives a premium from the purchaser. Options may be either exchange-traded or negotiated between the Group and a customer (over the counter).

b. Capital adequacy

The Bank and several of its subsidiaries are independently regulated by the Central Banks in their respective countries of operations. Each of these maintains its own statutory capital adequacy in conformity with the minimum requirements laid down by its regulator.

c. Financing and credit risk

The Group takes on exposure to financing risk which is the risk that a counterparty will be unable to pay amounts in full when due. The Group structures the levels of financing risk it undertakes by placing limits on the amount of risk accepted in relation to one customer, or

3. Financial risk management (continued)

groups of customers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of financing risk by product, industry sector and by country are approved by the boards of subsidiary companies.

The Group's exposure to any one customer including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

Exposure to financing risk is managed through regular analysis of the ability of customers and potential customers to meet capital and profit repayment obligations and by changing these lending limits where appropriate. Exposure to financing risk is also managed in part by obtaining collateral and corporate and personal guarantees.

The Group also has commitments to extend financing, the primary purpose of which is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same financing risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct borrowing.

Commitments to extend financing represent unused portions of authorisations to extend financings in the forms of Islamic transactions, guarantees or letters of credit. With respect to financing risk on commitments to extend financing, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend financing are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of financing commitments because longer-term commitments generally have a greater degree of financing risk than shorter-term commitments.

d. Derivatives

The Group maintains strict control limits on net open derivative positions, i.e. the difference between purchase and sale contracts, by both amount and term. At any one time the amount subject to financing risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets), which in relation to derivatives is only a small fraction of the contract or notional values used to express the volume of instruments outstanding. This financing risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements. Collateral or other security is not usually obtained for financing risk exposures on these instruments, except where the Group requires margin deposits from counterparties.

3. Financial risk management (continued)

e. Market risk

The Group takes on exposure to market risks. Market risks arise from open positions in currency, equity and other market rate products, all of which are exposed to general and specific market movements. In general, other market rate products are short term in nature which reduces the Group's exposure to risk. The Group estimates the market risk of positions held and the maximum losses expected based upon a number of assumptions for various changes in market conditions. The boards of directors of subsidiary companies set limits on the value of risk that may be accepted by the respective subsidiary.

f. Currency risk

The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The boards of directors of the Bank and its subsidiary companies set limits on the level of exposure by currency and in total for both overnight and intra-day positions. The Group uses forward foreign exchange contracts in its management of currency risks.

The Group's currency exposure is disclosed in note 37.

g. Liquidity risk

The Group is exposed to daily calls on its available cash resources from overnight investment funds, current accounts, maturing investments, financing draw downs and guarantees. The Group does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The boards of directors of subsidiary companies set limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of interbank and other financing facilities that should be in place to cover withdrawals at unexpected levels of demand. The Group operates in a number of regulated jurisdictions and consequently some Group assets are subject to regulatory restrictions with respect to liquidity.

4. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities, income and expenses. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment of investments in financings

The Group reviews its investments in financings to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the consolidated statement of income, judgements are made as to whether there is any observable data

4. Critical accounting estimates and judgements in applying accounting policies (continued)

indicating that there is a measurable decrease in the estimated future cash flows. This evidence may include observable data indicating that there has been an adverse change in the payment status of a borrower, or national or local economic conditions that correlate with defaults on assets. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Fair value and impairment of available-for-sale equity investments

The Group may from time to time hold investments in financial instruments that are not quoted in active markets. Fair values of such instruments are determined using valuation techniques. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by Group management.

Available-for-sale equity investments are deemed to be impaired when there has been a significant or prolonged decline in the fair value below cost. The determination of what is significant or prolonged requires judgement. Impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

On occasion the Group may hold investments whose fair value cannot be reliably measured. In those instances, full disclosure with a description of the investment, the carrying value and an explanation of why fair value cannot be measured reliably are included in the notes to the financial statements.

Special purpose entities

The Group sponsors the formation of special purpose entities (SPE's) primarily for the purpose of allowing clients to hold investments. The Group does not consolidate SPE's that it does not control. In determining whether the Group does control an SPE judgements are made about its exposure to the risks and rewards, as well as about its ability to make operational decisions for the SPE in question.

Income taxes

The Group is subject to income taxes in some jurisdictions. Estimates are required in determining the provision for income taxes. There are some transactions and calculations for which the ultimate tax determination is uncertain. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences impact the income tax and deferred tax provisions in the period in which such determination is made.

Use of estimates for equity accounting the results of the associates

On the basis that the financial statements of the underlying associates of the Group may not be available at the time of publication of the

4. Critical accounting estimates and judgements in applying accounting policies (continued)

financial statements of the Group, Management may from time to time be required to use estimates in its equity accounting of the results of these entities. These estimates are generally based on the results of the latest financial statements or management accounts.

Estimated impairment of goodwill

The Group tests annually whether goodwill has suffered any impairment, in accordance with the accounting policy stated in note 2. The recoverable amounts of cash-generating units have been determined based on estimated future cash flows and comparisons with market multiples. These calculations require the use of estimates, which are subject to judgement. Changes in the underlying assumptions may impact the reported numbers.

Pension obligations

The most significant assumptions the Group has to make in connection with the actuarial calculation of pension obligations and pension expenses affect the discount rate, the expected annual rate of compensation increase, the expected employee turnover rate, the expected average remaining working life, the expected annual adjustments to pensions and the expected annual return on plan assets. These assumptions are subject to review by the Group. A change in any of these key assumptions may have a significant impact on the projected benefit obligations, funding requirements and periodic pension cost.

5. Segments

a) Business segments

The Group and its associates are organised on a worldwide basis into the following business segments:

(i) retail banking incorporates private banking services, private customer current accounts, savings, deposits, investment savings products, custody, credit and debit cards, consumer loans and mortgages;

(ii) insurance includes life assurance, general insurance and reinsurance activities;

(iii) asset management encompasses managing clients' assets on either a fiduciary or trustee basis, carrying out securities trading operations, distributing mutual funds, granting documentary credit and other financings and holding deposits on behalf of clients.

(iv) corporate management comprises those activities of a supporting nature to the Group such as legal, financial control, audit and risk management, and the promotion of investment financing activities.

Transactions between the business segments are on normal commercial terms and conditions.

5. Segments (continued)

(Thousands of US dollars)

For the year ended 31 December 2006	Retail Banking	Insurance	Asset Mgmt	Corporate Mgmt	Elimination	Group
External income	56,458		39,017	24,159		119,634
Income from other segments			638	4,920	(5,558)	-
Total income	56,458		39,655	29,079	(5,558)	119,634
Operating expense	(19,476)		(17,991)	(12,020)		(49,487)
Foreign exchange	(40)		196	(257)		(101)
Operating profit	36,942		21,860	16,802	(5,558)	70,046
Gain on sale of subsidiary				105,541		105,541
Share of net profit in associates	12,880	2,080	866	4,482		20,308
Profit before tax	49,822	2,080	22,726	126,825	(5,558)	195,895
Tax expense	(9,728)		(704)	(1,693)		(12,125)
Profit for the year	40,094	2,080	22,022	125,132	(5,558)	183,770
Minority interests	(15,143)		(427)			(15,570)
Profit after minority interests	24,951	2,080	21,595	125,132	(5,558)	168,200
At 31 December 2006						
Segment assets	2,546,718		103,884	376,816		3,027,418
Investments in associates	35,653	62,368	24,103	30,396		152,520
Segment liabilities	2,074,530		32,808	87,762		2,195,100
Other segment items						
Depreciation	1,578		341	95		2,015
Amortisation of intangibles	2,076		11	1		2,088

5. Segments (continued)

(Thousands of US dollars)

For the year ended 31 December 2005	Retail Banking	Insurance	Asset Mgmt	Corporate Mgmt	Elimination	Group
External income			31,009	12,045		43,054
Income from other segments			471	38,288	(38,759)	
Total income			31,480	50,333	(38,759)	43,054
Operating expense			(15,121)	(14,478)		(29,599)
Foreign exchange			729	(690)		39
Operating profit			17,088	35,165	(38,759)	13,494
Share of net profit in associates	22,747	75	1,115	1,147		25,084
Profit before tax	22,747	75	18,203	36,312	(38,759)	38,578
Tax expense			(59)	(943)		(1,002)
Profit for the year	22,747	75	18,144	35,369	(38,759)	37,576
minority interests			(1,043)			(1,043)
Profit after minority interests	22,747	75	17,101	35,369	(38,759)	36,533
At 31 December 2005						
Segment assets			115,833	169,064		284,897
Investments in associates	85,438	40,318	23,227	8,468		157,451
Segment liabilities			61,793	127,778		189,571
Other segment items						
Depreciation			539	138		677

b) Geographical segments

A geographical segment is engaged in providing products and services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments. The Group is organised in four geographical segments which are Bahrain, other Middle East, Pakistan and Europe.

5. Segments (continued)

The analysis below is based on legal vehicles. (Thousands of US dollars)

For the year ended 31 December 2006

	Bahrain	Asia	Other Middle East	Pakistan	Europe	Group
Segment income	36,920		28,060	39,223	15,431	119,634
Gain on sale of subsidiary	105,541					105,541
Share of net profit in associates	8,842		535	10,065	866	20,308
Profit before tax	147,307		15,064	34,164	(640)	195,895
Tax expense	(1,412)			(8,900)	(1,813)	(12,125)
Profit for the year	145,895		15,064	25,264	(2,453)	183,770
Minority interests	(5,599)			(9,544)	(427)	(15,570)
Profit after minority interests	140,296		15,064	15,720	(2,880)	168,200
At 31 December 2006						
Segment assets	912,924		(11,233)	1,891,729	233,998	3,027,418
Investments in associates	115,049	24,090	8,006	5,375		152,520
Segment liabilities	489,214			1,666,831	39,055	2,195,100

For the period ended 31 December 2005

	Bahrain	Other Middle East	Pakistan	Europe	Group
Segment income	2,998	24,687		15,369	43,054
Share of net profit in associates	75	9,430	14,463	1,116	25,084
Profit before tax	(4)	20,708	14,430	3,444	38,578
Tax expense	(398)			(604)	(1,002)
Profit for the year	(402)	20,708	14,430	2,840	37,576
Minority interests				(1,043)	(1,043)
Profit after minority interests	(402)	20,708	14,430	1,797	36,533
At 31 December 2005					
Segment assets	142,485	41,005		101,407	284,897
Investments associates	40,318	27,031	66,876	23,226	157,451
Segment liabilities	107,812	28,970		52,789	189,571

(Thousands of US dollars)

6.Trading securities

	2006	2005
Trading securities – at fair value		
- Listed	394	-
- Unlisted	-	211
	394	211

7. Derivative financial instruments

		2006	
	Notional	Fair values	
	Amount	Assets	Liabilities
Foreign exchange derivatives held for trading:			
Currency forwards purchased	170,140	-	293
Currency forwards sold	114,006	155	-
At 31 December 2006		155	293

8. Investments in financings

	2006	2005
Investments in financings	1,453,367	99,795
Financings subject to finance leases	233,347	-
Provision for impairment	(51,679)	-
	1,635,035	99,795

Financings subject to finance leases

	2006		
	Gross investment in finance leases receivable	Unearned future finance income on finance leases	Net investment in finance leases
Not later than one year	74,095	(22,803)	51,292
Later than one year and not later than five years	214,892	(32,837)	182,055
	288,987	(55,640)	233,347

The allowance for uncollectible finance lease receivables included in the provision for impairment amounted to $5.6 million at 31 December 2006.

(Thousands of US dollars)

9. Investment securities

	2006	2005
Investment securities available-for-sale		
Investment securities – at fair value		
- Listed	192,258	8,352
- Unlisted	210,832	27,201
	403,090	35,553

Gains less losses from investment securities

	2006	2005
Derecognition of available-for-sale assets	70	420
Impairment provision	(1,589)	(221)
Other	318	69
	(1,201)	268

The movement in investment securities may be summarized as follows:

	2006	2005
At 1 January	35,553	38,654
Subsidiary acquisitions	541,501	-
Additions	43,147	3,600
Disposals	(209,742)	(8,444)
Net gains/(losses) from changes in fair value	(999)	1,987
Exchange differences	(4,781)	(23)
Provision for impairment	(1,589)	(221)
At 31 December	403,090	35,553

Investments with a carrying value of $1.3 million (2005: $1.1 million) are stated at cost as there is no basis for determining fair value. Such investments are managed by an external investment manager who has not provided an estimate of fair value nor sufficient information for a fair value to be determined, but who has indicated that there has been no impairment. Each investment is in a special purpose company established by the investment manager for the purposes of pooling funds with other investors to invest in specific underlying securities. Both the special purpose companies and the underlying securities are unlisted and unmarketable until such time as they are liquidated by the investment manager and the proceeds distributed to investors.

(Thousands of US dollars)

10. Investment property

	2006	2005
At 1 January	43,769	49,985
Subsidiary acquisitions	8,208	-
Additions	7,910	3,647
Disposals	(7,720)	(2,282)
Fair value gains/(losses) during the year	13,205	(1,003)
Net exchange differences	2,394	(6,578)
At 31 December	67,766	43,769

Rental income from investment property amounting to $1.2 million (2005: $1.5 million) has been included in the consolidated statement of income under other income. Direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income amounted to $0.7 million (2005: $0.6 million). Direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income amounted to $0.1 (2005: $Nil). Such expenses have been included in the consolidated statement of income under general and administrative expenses.

Investment property under operating leases

The Group leases out part of its investment property under operating leases. The leases are for terms of one to five years. There were no contingent rents in 2006 (2005: $Nil).

The future aggregate minimum rentals receivable under non cancellable operating leases are as follows:

	2006	2005
Not later than one year	1,286	1,097
Later than one year and not later than five years	1,789	2,509
	3,075	3,606

11. Accounts receivable

	2006	2005
Accounts receivable	28,804	12,141
Provision for impairment	(84)	(1,110)
Funds under management	30,859	9,744
Receivables from parent company (Note 32)	-	810
Receivables from affiliated companies (Note 32)	6,128	54,654
Receivables from associated companies (Note 32)	40	790
	65,747	77,029

(Thousands of US dollars)

11. Accounts receivable (continued)

Included in accounts receivable are prepayments in the amount of $6.6 million (2005: $3.2 million) and loans to employees and directors of $7.3 million (2005: $3.5 million). The remaining balance relates primarily to project management fees and dividends receivable.

Included in the receivable from funds under management at 31 December 2006 is $9.3 million in bridge financings made to real estate development funds which are sponsored by a subsidiary of the Group. Bridge financings are generally short-term in nature. The balance represents profit sharing, Management fees and other fees and expenses due from clients.

12. Investments in associates

		2006	2005
At 1 January		157,451	157,583
Subsidiary acquisitions	(note 33)	28,631	-
Conversion to subsidiaries through acquisitions of controlling interest	(note 33)	(90,916)	-
Share of results before tax		18,590	25,484
Share of tax		(2,895)	(4,997)
Dividends paid		(4,596)	(6,864)
Share of fair value gains		(5,193)	12,048
Additions	(note 33)	71,549	-
Disposals	(note 33)	(18,521)	(24,505)
Exchange differences		(1,580)	(1,298)
At 31 December		152,520	157,451

(Thousands of US dollars)

12. Investments in associates (continued)

The summarized financial information the Group's principal associates is as follows :

Name and Country of incorporation	Assets	Liabilities	Income	Profit/ (loss)	Published price quotation	- %owned - Voting	Economic
2006							
Listed:							
Meezan Bank Limited (Pakistan)	764,447	696,344	28,940	10,221	19.55 PKR	26	15
Faysal Income & Growth Fund (Pakistan)	21,430	47	2,428	2,168	106.46 PKR	23	12
Unlisted:							
Solidarity Company BSC (c) (Bahrain)	203,642	43,267	15,150	5,354		40	40
First Leasing Bank B.S.C. (Closed) (Bahrain)	99,222	2,214	1,454	(252)		21	21
Citic International Assets Management Limited (Hong Kong)	211,002	18,059	7,424	4,825		20	13
Sanpak Engineering (Pakistan)	11,697	6,796	2,854	1,606		31	18
*Islamic Company for Production, Printing and Packing Materials "Icopack" (Egypt)	16,997	7,210	11,333	925		23	23
*Misr Company for Packing Materials "Egywrap" (Egypt)	35,583	19,448	30,712	1,302		23	23
Sakana Holistic Housing Solutions B.S.C. (Closed) (Bahrain)	6,631	-	-	-		50	30
Faysal Asset Management Limited (Pakistan)	1,407	57	1,420	460		30	15

* For some of the associates, published information is not available for 31 December 2006 and therefore the income and profit and loss have been arrived at by using the 2005 audited financial statements and projecting that for 2006. For presentation purposes, the assets and liabilities for these associates, however, represent the amounts as audited at 31 December 2005.

(Thousands of US dollars)

12. Investments in associates (continued)

Name and Country of incorporation	Assets	Liabilities	Income	Profit/ (loss)	Published price quotation	%owned Voting	Economic
2005							
Listed:							
Faysal Bank Limited (Pakistan)	1,851,466	1,614,568	91,026	51,236	74.10 PKR	28	28
Faisal Islamic Bank of Egypt (Egypt)	2,857,845	2,738,347	128,355	17,260	68.01 USD	10	10
Unlisted:							
Faisal Private Bank (Switzerland) S.A.	72,213	24,843	13,646	2,275	-	49	49
Solidarity Company BSC (c) (Bahrain)	138,942	34,830	10,328	347	-	40	40
*Islamic Company for Production, Printing and Packing Materials "Icopack" (Egypt)	14,264	4,734	11,001	1,334	-	23	23
*Misr Company for Packing Materials "Egywrap" (Egypt)	27,832	12,095	18,449	3,408	-	23	23

*For some of the associates, published information is not available for 31 December 2005 and therefore the income and profit and loss have been arrived at by using the 2004 audited financial statements. The assets and liabilities for these associates, however, represent the amounts as reported at 31 December 2004.

PKR: Pakistan Rupee
USD: United States Dollar

Included in investment in associates at 31 December 2006 is $3.7 million (31 December 2005: $17.5 million) of unamortized goodwill. The movement is as follows:

	2006	2005
At 1 January	17,548	17,548
Additions	1,677	-
Disposal of associated company	(15,560)	-
At 31 December	3,665	17,548

(Thousands of US dollars)

13. Property, plant and equipment

	Land and buildings	Leasehold property, furniture, equipment and motor vehicles	Total
Cost			
At 1 January 2006	1,620	4,841	6,461
Subsidiary acquisitions	18,037	27,832	45,869
Additions	252	10,175	10,427
Disposals	(12,432)	-	(12,432)
Currency effect	(325)	(37)	(362)
At 31 December 2006	7,152	42,811	49,963
Depreciation			
At 1 January 2006	387	3,740	4,127
Subsidiary acquisitions	922	13,048	13,970
Charge for the year	(142)	2,157	2,015
Disposals	(147)	(736)	(883)
Currency effect	(28)	61	33
At 31 December 2006	992	18,270	19,262
Net book value			
At 31 December 2006	6,160	24,541	30,701
Cost			
At 1 January 2005	1,620	5,547	7,167
Additions	-	331	331
Disposals	-	(211)	(211)
Transfer to intangibles	-	(471)	(471)
Currency effect	-	(355)	(355)
At 31 December 2005	1,620	4,841	6,461
Depreciation			
At 1 January 2005	352	3,588	3,940
Charge for the year	35	642	677
Disposals	-	(194)	(194)
Transfer to intangibles	-	(2)	(2)
Currency effect		(294)	(294)
At 31 December 2005	387	3,740	4,127
Net book value			
At 31 December 2005	1,233	1,101	2,334

Leasehold property at 31 December 2006 aggregated $15.7 million (2005: $1.1 million), less accumulated depreciation of $2.9 million (2005: $0.7 million).

Equipment and motor vehicles at 31 December 2006 included $0.2 million at net carrying cost subject to finance leases.

(Thousands of US dollars)

14. Intangible assets

	Goodwill	Customer relations	Core deposits	Other*	Total
Year ended 31 December 2005					
Opening net book amount				-	-
Additions				533	533
Amortisation				(2)	(2)
Closing net book amount				531	531
At 31 December 2005					
Cost				533	533
Accumulated amortisation				(2)	(2)
Net book amount				531	531
Year ended 31 December 2006					
Opening net book amount				531	531
Acquisition of a subsidiary (note 33)	97,836	39,558	59,339	1,738	198,471
Additions				4,340	4,340
Disposals				(740)	(740)
Foreign exchange				(17)	(17)
Amortisation charge		(742)	(1,113)	(233)	(2,088)
Closing net book amount	97,836	38,816	58,226	5,619	200,497
At 31 December 2006					
Cost	97,836	39,558	59,339	7,001	203,734
Accumulation amortisation		(742)	(1,113)	(1,382)	(3,237)
Net book amount	97,836	38,816	58,226	5,619	200,497

*Other intangible assets included $4.0 million at 31 December 2006 (2005: $0.5 million) of computer software related to core banking systems, which is being amortised over five years.

15. Non-current assets held for sale

Non-current assets held for sale at 31 December 2006 amounting to $2.2 million related to property located in Pakistan, which has been identified to be sold by the management of Faysal Bank Limited.

(Thousands of US dollars)

16. Accounts payable

	2006	2005
Accounts payable and other provisions	15,107	2,162
Demand drafts	80,940	-
Accruals	20,443	10,146
Security deposits on consumer leases	45,957	-
Funds under management	574	5,176
Due to the parent company (Note 32)	-	28,169
Payables to affiliated companies (Note 32)	2,494	5,555
Payables to associated companies (Note 32)	-	4,637
Payables to directors	468	15
Deferred income	6,346	42
Finance lease liabilities	241	-
	172,570	55,902

Liabilities against assets subject to finance leases comprise:

	2006		
	Minimum lease payments	Financial charges for future periods	Principal outstanding
Not later than one year	106	(12)	94
Later than one year and not later than five years	153	(6)	147
	259	(18)	241

17. Deferred tax

	2006	2005
At January	3,087	3,868
Subsidiary acquisition	24,724	-
Income statement charge/(credit)	8,273	(244)
Investment security fair value measurement	3	-
Exchange differences	(17)	(537)
At 31 December	36,070	3,087
Deferred tax asset on provisions and tax losses carried forward	(3,270)	-
Deferred tax asset on available-for-sale investments	1,355	-
Deferred tax liability on leasing transactions	(29,229)	-
	(31,144)	-

(Thousands of US dollars)

17. Deferred tax (continued)

The Group recognised deferred tax assets in 2006 of $1.4 million and a deferred tax liability of $32.5 million. For balance sheet presentation purposes, the deferred tax assets and the deferred tax liability have been offset, since both arose in the same tax jurisdiction.

	2006	2005
Deferred tax liability on the revaluation of investment property at fair value	(3,894)	(3,087)
Deferred tax liability on provisions	(1,032)	-
	(4,926)	(3,087)

18. Net trading income

	2006	2005
Gains/(losses) on trading securities	21	-
Gains/(losses) on revaluation of trading securities	(46)	-
Income from foreign exchange trading	1,612	-
	1,587	-

Foreign exchange trading includes gains and losses from spot and forward contracts translated foreign currency assets and liabilities.

19. Income from investments in financings

	2006	2005
Income from investments in financings	58,868	2,166
Provision for impairment	(2,676)	(93)
Reversal of provision for impairment	439	-
	56,631	2,073

20. Fee and commission income

	2006	2005
Structuring fees and commissions	2,821	2,697
Arrangement fees	3,308	-
Document credit fees	1,300	-
Selling commission	1,362	-
Financing fees	2,364	-
Fees from affiliated companies	5,522	2,166
Fees from associated companies	3,965	-
Other fees	7,087	4,311
	27,729	9,174

21. Dividend income

	2006	2005
Investment securities available-for-sale	825	-

(Thousands of US dollars)

22. Other income

	2006	2005
Fees from parent company (Note 32)	-	7,818
Fees from affiliated companies (Note 32)	-	-
Fees from associated companies (Note 32)	-	1,138
Income from investment property	1,201	1,481
Gain/(loss) on revaluation of investment property	13,204	(2,272)
Other income	1,215	139
	15,620	8,304

23. Staff costs

	2006	2005
Salaries	20,086	13,825
Social security and other statutory costs	1,989	1,491
Post retirement benefits	1,435	1,262
Other benefits	4,556	4,033
	28,066	20,611

The number of persons employed by the Group at 31 December 2006 was 1,735 (2005: 248).

Other benefits include housing allowance, home leave, relocation expense, medical and health expense, training, severance costs and end of service benefit costs.

24. Proposed dividend

A dividend for 2005 amounting to $20.0 million ($0.13 per share) was approved and paid in 2006. A dividend for 2004 amounting to $10.0 million ($0.65 per share) was approved and paid in 2005. The Directors propose to recommend at the Annual General Meeting a dividend of $47.7 million ($0.135 per share) for the year ended 31 December 2006.

25. Taxes

	2006	2005
Current taxes	3,852	1,246
Deferred taxes	8,273	(244)
	12,125	1,002

The expected income tax expense for the Group is an aggregate of individual amounts representing the mix of profits and losses and the applicable tax rates in each jurisdiction. Consequently, the effective tax rate on consolidated income may vary from year to year, according to the source of earnings. Most affiliates of the Group operate in tax free jurisdictions.

(Thousands of US dollars)

25. Taxes (continued)

A reconciliation between the reported income tax and the amount computed, using the weighted average of applicable domestic corporate tax rates, is as follows:

	2006	2005
Weighted average applicable domestic corporate tax	13,382	1,002
Effect of revenue taxed at a different rate than domestic corporate tax rate	(1,257)	-
Effective tax	12,125	1,002

The Bank operates in certain countries which have tax regimes, but for which no provision for income tax has been recorded in these consolidated financial statements. It is believed that the Bank's potential tax liability arising in respect of its operations in those countries is remote at the present time.

26. Minority interests

The consolidated financial statements include 100% of the assets, liabilities and earnings of subsidiaries. The ownership interests of the other shareholders in the subsidiaries are called minority interests.

The following table summarizes the minority shareholders' interests in the equity of consolidated subsidiaries.

	2006		2005	
	Minority %		Minority %	
Shamil Bank of Bahrain B.S.C.	40	118,302	-	-
Faysal Bank Limited	49	104,858	-	-
Faisal Private Bank (Switzerland) S.A.	21	1,938	-	-
Faisal Finance (Jersey) Limited	5	1,249	25	5,418
		226,347		5,418

Minority interests in the consolidated statement of income of $15.6 million (2005: $1.0 million) represent the minority shareholders' share of the earnings of these subsidiaries for the respective years.

(Thousands of US dollars)

27. Share capital

	Number of shares (thousands)	Share Capital
At 1 January 2005	150,000	150,000
At 31 December 2005	150,000	150,000
Shares issued	210,000	210,000
Treasury shares purchased (net)	(6,475)	(6,475)
At 31 December 2006	353,525	353,525

The total authorised number of shares is 500 million (2005: 300 million) with a nominal value of $1.00 (2005: $1.00) per share. All issued shares are fully paid.

The Bank owned 6,475,111 of its own shares at 31 December 2006 (2005: Nil). The shares were acquired through various purchases and sales during the year on the Bahrain Stock Exchange for a net consideration of $12,985,072. The nominal value of the shares acquired amounting to $6,475,111 has been deducted from share capital and the balance of the consideration has been deducted from the statutory reserve. The shares are held as Treasury shares and the Bank has the right to reissue these shares at a later date.

In accordance with the requirements of the Bahrain Commercial Companies Law, an amount of at least 10% of the Bank's net income for the year is transferred to a statutory reserve until such time as that reserve represents 50% of the paid up share capital of the Bank. The reserve can be utilised for payment of dividends up to 5% of the issued and fully paid up share capital.

28. Basic/diluted earnings per share

Basic/diluted earnings per share is calculated by dividing the net income attributable to shareholders by the weighted average number of issued and fully paid up ordinary shares during the period.

	2006	2005
Net income attributable to shareholders	168,200	36,533
Weighted average number of issued and fully paid up ordinary shares ('000)	305,545	150,000
Basic/diluted earnings per share	US cts 55	US cts 24

29. Private placement and initial public offering

In December 2005, the Bank offered 50,000,000 new shares through a fully underwritten issue to existing unit holders and certain employees of Dar Al-Maal Al-Islami Trust through a private placement. This offer was subsequently increased to 60,000,000 shares.

(Thousands of US dollars)

29. Private placement and initial public offering (continued)

These shares were offered at $1.00 per share and were on allotment subject to the same rights and obligations as were applicable to other shares in the Bank apart from the entitlement to dividends in respect of the year ended 31 December 2005. The shares offered through the private placement were allotted on the closing when the Bank received the proceeds on 9 April 2006.

On 19 February 2006, the Bank offered 150,000,000 new shares through an initial public offering at a price of $2.25 per share. Following the successful completion of both the private placement and the initial public offering, the Bank's issued and paid up capital was increased to $360 million.

Expenses amounting to $0.9 million had been incurred in connection with the private placement and the initial public offering at 31 December 2005. Of this amount, $0.1 million was recognised in the consolidated statement of profit and loss and $0.8 million was charged directly to equity. Additional expenses amounting to $14.7 million have been incurred during 2006, which have been charged directly to equity.

Certain employees subscribed for shares in the Bank in the private placement. The benefit received by these employees amounted to $1.0 million, representing the difference between the deemed fair value of the shares and the subscription price, which has been recognised as an expense in the consolidated condensed statement of income.

30. Funds under management

Funds under management aggregated $1.1 billion (2005: $1.5 billion) and represented amounts invested by clients and placed with funds managed by the Group. These funds are invested without recourse to the Group. The Group earned fees of approximately $43.3 million associated with such funds in 2006 (2005: $24.8 million).

At 31 December 2006, the Group had amounts due to funds under management of $5.0 million (2005: $119.3 million) and due from funds under management of $310.4 million (2005: $20.8 million). Included in amounts due to funds under management at 31 December 2005 was an amount of $92.5 million, which related to investments received from off balance sheet funds and which was subsequently reinvested in investments in financings outside of the Group. The remaining amount represented off balance sheet funds invested with the Group's subsidiaries.

31. Retirement benefit plans

Substantially all employees of the Group's European incorporated subsidiaries are covered either by insured or state pension plans. In accordance with local practice, no pension plans exist in certain countries in which the Group operates.

The Group's principal retirement benefit plans are in Switzerland and are defined benefit plans. The assets of the funded plans are held in separate trustee administered funds. These plans are valued by independent actuaries every year using the projected unit credit method.

(Thousands of US dollars)

31. Retirement benefit plans (continued)

The assumptions used in the actuarial valuations for 2006 and 2005 are the best estimates of the main parameters influencing the pension liability and are detailed as follows:

	2006	2005
	%	%
Standard financial cost rate	2.70	3.10
Expected long-term rates of return on plan assets	3.70	3.40
Rate of increase in compensation	2.00	2.00
Rate of increase in pension	0.00	0.00
The funded status of the Group's pension plans is as follows:		
Projected benefits obligations	(48,734)	(32,676)
Plan assets at fair values	43,295	29,006
Funded status	(5,439)	(3,670)
Unrecognised actuarial losses	3,902	2,730
Liability in the balance sheet	(1,537)	(940)
Net periodic pension cost consists of the following:		
Service costs	2,081	1,562
Financial costs	1,245	942
Expected return on assets	(1,454)	(927)
Total cost	1,872	1,577
Employee contributions	(437)	(315)
Net periodic pension cost	1,435	1,262
Movement in the liability recognised in the balance sheet:		
At 1 January	940	1,145
Acquisition of subsidiary	392	-
Exchange differences	542	159
Net periodic pension cost	1,435	1,262
Employer contributions	(1,772)	(1,626)
At 31 December	1,537	940

(Thousands of US dollars)

31. Retirement benefit plans (continued)

The movement in the defined benefit obligation over the year is as follows :

	2006	2005
Beginning of the year	32,676	31,627
Acquisition of subsidiary	9,684	-
Service costs	2,081	1,562
Financial costs	1,245	942
Employee contributions	437	315
Actuarial (gain)/loss	-	3,280
Benefits paid	(1,537)	(536)
Premiums paid	(452)	-
Net transfer in/(out)	1,248	-
Exchange differences	3,352	(4,514)
End of year	48,734	32,676

The movement in the fair value of plan assets of the year is as follows:

Beginning of the year	29,006	29,165
Acquisition of subsidiary	8,400	-
Expected return on plan assets	1,454	927
Actuarial (gain)/(loss)	-	1,682
Employer contributions	1,772	1,626
Employee contributions	437	315
Benefits paid	(1,537)	(536)
Premiums paid	(452)	-
Acquisition/divestures	1,248	-
Exchange differences	2,967	(4,173)
End of year	43,295	29,006

The expected return on plan assets is determined by considering the expected returns available on the assets underlying the current investment policy. Expected returns on fixed rate investments are based upon gross redemption yields as at the balance sheet date. Expected returns on equity and property investments reflect long-term real rates of return experienced in the respective markets. The expected return for each asset class was weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio.

(Thousands of US dollars)

31. Retirement benefit plans (continued)

Expected contributions to post employment benefit plans for the year ending 31 December 2007 is $1.6 million.

As at 31 December	2006	2005	2004	2003
Present value of defined benefit obligation	48,734	32,676	31,627	27,499
Fair value of plan assets	43,295	29,006	29,165	25,533
Deficit/(surplus)	5,440	3,671	2,461	1,966
Experience adjustments on plan assets	-	(1,682)	788	1,892
Experience adjustments on plan liabilities	-	3,280	(615)	(1,622)

32. Related party transactions

A number of transactions are entered into with related parties in the normal course of business. These include loans, current and investment accounts. Transactions and balances disclosed as with associated companies are those with companies in which the Bank owns 20% to 50% of the voting rights and over which it exerts significant influence, but does not have control. Transactions with other related parties, who consist of the Dar Al-Maal Al-Islami Trust and its subsidiaries other than the Bank, are disclosed as affiliated companies. The volumes of related party transactions, outstanding balances at the year end, and relating income and expense for the year are as follows.

a) Loans to key management personnel

	2006	2005
Loans		
Loans outstanding at 1 January	2,043	2,190
Loans issued during the year	-	572
Loan repayments during the year	(1,180)	(492)
Foreign exchange	104	(227)
Loans outstanding at 31 December	967	2,043

No provisions have been recognised in respect of loans given to related parties (2005: Nil).

The loans advanced to key management personnel bear no return, are unsecured and are repayable over varying periods up to 2011.

b) Loans to employees

All employees of the Group are entitled to receive employee loans on favourable terms not equivalent to those of transactions made on an arm's length basis. Included in accounts receivable are amounts due from employees at 31 December 2006 of $7.3 million (2005: $3.5 million).

(Thousands of US dollars)

32. Related party transactions (continued)

c) Current and investments accounts

For the period ended	Associated companies 2006	Associated companies 2005	Affiliated companies 2006	Affiliated companies 2005
Amounts payable to:				
Solidarity Company B.S.C. (c)	21,097	-	-	-
Faisal Private Bank (Switzerland) S.A.	-	916	-	-
Faysal Bank Limited	-	3,721	-	-
Faisal Islamic Bank of Egypt	-	4,898	-	-
Shamil Bank Bahrain B.S.C.	-	-	-	5,555
Dar Al-Maal Al-Islami Trust	-	-	-	28,169
DMI Services N.V.**	-	-	80	-
Islamic Investment Company of the Gulf (Bahamas) Limited	-	-	27	-
Gulf Company for Financial Investments	-	-	2,445	-
First Leasing Bank B.S.C. (Closed)	50,022	-	-	-

**Formerly Plumeria (Antilles) N.V.

	Associated companies 2006	Associated companies 2005	Affiliated companies 2006	Affiliated companies 2005
Amounts receivable from:				
Solidarity Company B.S.C. (c)	28	-	-	-
Meezan Bank Limited	12	-	-	-
Faisal Private Bank (Switzerland) S.A.	-	789	-	-
Faysal Bank Limited	-	1	-	-
Shamil Bank Bahrain B.S.C.	-	-	-	33,498
DMI Services N.V.	-	-	15,580	21,156
Dar Al-Maal Al-Islami Trust	-	-	197,822	810
Islamic Investment Company of the Gulf (Bahamas) Limited	-	-	10,009	-
Faysal Bahamas Limited	-	-	26	-
Gulf Company for Financial Investments	-	-	5	-
Egyptian Company for Business and Trade	-	-	817	-

(Thousands of US dollars)

32. Related party transactions (continued)

	Associated companies		Affiliated companies	
For the period ended	2006	2005	2006	2005
Expense on current and investment accounts				
Faisal Private Bank (Switzerland) S.A.*	194	200	-	-
Faysal Bank Limited*	47	39	-	-
Shamil Bank Bahrain B.S.C.*	-	-	165	-
Dar Al-Maal Al-Islami Trust	-	-	171	278
Gulf Company for Financial Investments	-	-	60	-
Solidarity Company B.S.C. (c)	648	-	-	-
First Leasing Bank B.S.C.(Closed)	22	-	-	-
d) Other revenue				
Faisal Private Bank (Switzerland) S.A.*	80	75	-	-
Faysal Bank Limited*	406	1,138	-	-
Dar Al-Maal Al-Islami Trust	-	-	6,166	7,818
DMI Services N.V.	-	-	8,395	534
Shamil Bank Bahrain B.S.C.*	-	-	1,715	2,888
Islamic Investment Company of the Gulf (Bahamas) Limited	-	-	736	-
First Leasing Bank B.S.C. (Closed)	3,797	-	-	-

* 2006 transactions represent the period from 1 January to 15 August

The fees paid by Dar Al-Maal Al-Islami Trust in 2005 represented the recovery of certain costs incurred on its behalf by a subsidiary company which were included in other income (note 22). Under a new arrangement, these costs have been recovered from DMI Services N.V. and recognised as a reduction of staff costs and administrative expenses in 2006. The fees paid by Shamil Bank of Bahrain B.S.C. in 2005 were due under an agreement, which has since been terminated, with a subsidiary company which provided services to it in the Kingdom of Saudi Arabia. In 2006, the revenue represents principally investment income received from Shamil Bank of Bahrain less advisory fees paid to it in connection with the initial public offering of the Bank's shares (note 29).

Details of other related party transactions during the period are contained in note 34 below.

	2006	2005
e) Key management compensation		
Salaries and other short-term benefits	14,396	8,652
Share based payments	1,029	-
Post-employment benefits	822	1,144
	16,247	9,796

(Thousands of US dollars)

32. Related party transactions (continued)

f) Director's remuneration

The total remuneration of the Board of Directors in 2006 amounted to $806,500 (2005: Nil).

g) Indemnity

Dar Al-Maal Al-Islami Trust has provided indemnities up to $3.5 million (2005: $2.5 million) in respect of any shortfall on the carrying values which may be realised on certain investments held by subsidiaries.

33. Acquisitions and disposals

In December 2005, the Bank disposed of 7.7% of its investment in Faisal Islamic Bank of Egypt to Dar Al-Maal Al-Islami Trust for a consideration of $17.0 million and disposed of 5.5% to Shamil Bank of Bahrain B.S.C. for a consideration of $12.1 million. The consideration for both transactions was determined by an agreed fair value for deferred settlement in 2006. The gain on disposal amounting to $4.6 million, representing the difference between the aggregate consideration of $29.1 million and the carrying value of $24.5 million, was recognised in the consolidated statement of income in 2005. Following these transactions, the Group's interest in FIBE was reduced to 9.9%.

In June 2006, the Bank disposed of 7.5% of its investment in Faisal Islamic Bank of Egypt to Dar Al-Maal Al-Islami Trust for a consideration of $18.8 million. The consideration for this transaction was determined by an agreed fair value for settlement in September 2006. The gain on disposal amounting to $4.6 million, representing the difference between the consideration and the carrying value of $14.2 million, has as been recognised in the consolidated statement of income in 2006. Following this transaction, the Group's interest in FIBE was reduced to 2.4% which was subsequently disposed of as part of the sale of Islamic Investment Company of the Gulf (Bahamas) Limited referred to below.

On 20 June 2006, the Bank subscribed $20.0 million for an additional 20 million shares in the capital of Solidarity Company BSC (c) at par.

On 15 August 2006 the Bank purchased on the Bahrain Stock Exchange 136,979,173 shares, representing 60% of the issued share capital of Shamil Bank of Bahrain B.S.C. at a price of $2.93 per share from Dar Al-Maal Al-Islami Trust. The total consideration amounted to $401.3 million. The Bank indirectly acquired a controlling interest in Faisal Private Bank (Switzerland) S.A. (formerly Faisal Finance (Switzerland) S.A.) and a controlling interest in Faysal Bank Limited, Pakistan. Further the Bank increased its ownership of Faisal Finance (Jersey) Limited.

The Group has assessed the fair values of the acquired companies' tangible and intangible assets, liabilities and contingent liabilities. The acquired companies have been consolidated with effect from the date of acquisition and the excess of consideration over the fair value of the net assets acquired amounting to $97.8 million has been included under goodwill.

(Thousands of US dollars)

33. Acquisitions and disposals (continued)

Purchase consideration	401,349
Elimination of minority interests in a subsidiary	(8,256)
Elimination of pre-acquisition expenses	3,530
Fair value of net assets acquired	(298,787)
Goodwill (note 14)	97,836

The details of the assets and liabilities acquired are as follows:

	Fair value	Acquirees' carrying amount
Cash and cash equivalents	423,796	423,796
Investments	44,076	44,076
Investments in financings	199,362	199,362
Investment securities	86,811	86,811
Investment property	10,157	10,157
Accounts receivable	116,591	116,591
Investments in associates	118,061	118,061
Property, plant and equipment	4,347	4,347
Customer related intangible assets	39,558	-
Core deposit intangible assets	59,339	-
Other intangible assets	1,738	-
Other assets	1,340	1,340
Investment accounts	(151,739)	(151,739)
Due to banks	(307,891)	(307,891)
Accounts payable	(180,666)	(180,666)
Other liabilities	(965)	(965)
Minority Interests	(165,128)	(165,128)
Total assets and liabilities acquired	298,787	198,152
Cash and cash equivalents transferred		423,796
Purchase consideration settled in cash		401,349
Cash inflow on acquisition		22,447

The indirect acquisition of Faysal Bank Limited, Pakistan, increased the cash inflow by $233.9 million. The profit of Shamil Bank of Bahrain B.S.C. since the acquisition date included in the Bank's consolidated statement of income for the twelve month period ended 31 December 2006 amounted to $12.8 million. If the acquisition had occurred on 1 January 2006, the consolidated profit after taxes for the twelve months ended 31 December 2006 would have been $223.7 million.

On 15 August 2006 the Bank sold 100% of the share capital in Islamic Investment Company of the Gulf (Bahamas) Limited to Dar Al-Maal Al-Islami Trust for a total consideration of $150.0 million.

(Thousands of US dollars)

33. Acquisitions and disposals (continued)

This transaction resulted in a gain on sale of a subsidiary of $105.5 million which is included in the consolidated statement of income.

Included in the sale were the following wholly-owned subsidiaries of Islamic Investment Company of the Gulf (Bahamas) Limited:

Subsidiary	Country of Incorporation
Islamic Investment Company of the Gulf (Sharjah)	United Arab Emirates
Gulf Company for Financial Investments S.A.E.	Egypt
Egyptian Company for Business and Trade S.A.E.	Egypt
Faysal Bahamas Limited	Bahamas

The details of the assets and liabilities sold are as follows:

Cash and cash equivalents	15,624
Investments	16,160
Trading securities	208
Investments in financings	8,811
Investment securities	33,754
Investment property	1,948
Accounts receivable	26,907
Property, plant and equipment	2,471
Other assets	740
Investments from off balance sheet funds	(29,795)
Accounts payable	(31,565)
Total assets and liabilities sold	45,263
Cash and cash equivalents transferred	15,624
Sale consideration settled in cash	150,000
Cash inflow on disposal	134,376

On 22 February 2006 the Bank acquired 2,250,000 shares in First Leasing Bank B.S.C. (Closed) for a total consideration of $2.4 million. On 28 December 2006 the Bank subscribed for a further 19,073,810 new shares at a price of $1.05 per share amounting to $20.0 million. At 31 December 2006 the Bank owned 21,323,810 shares, representing 21.3% of the total issued share capital of First Leasing Bank B.S.C. (Closed).

On 28 December 2006 the Bank acquired 124,816,636 shares in Citic International Assets Management Limited for a total consideration of Hong Kong dollars 131.4 million ($16.9 million). On the same date the Bank subscribed for a further 318,716,898 new shares at a total cost of Hong Kong dollars 335.2 million, of which Hong Kong dollars 55.3 million ($7.1 million) was payable on initial subscription.

(Thousands of US dollars)

33. Acquisitions and disposals (continued)

The balance is payable over a period not exceeding two years upon calls being made by the directors. At 31 December 2006 the Bank held 20% of the issued share capital of Citic International Assets Management Limited and was entitled to an equity interest of 12.5%.

34. Contingent liabilities and commitments

Contingent liabilities	2006	2005
Acceptances and endorsements	61,302	-
Guarantees and irrevocable letters of credit	508,865	18,626
Customer claims	54,862	-
Assets pledged as Collateral	111,151	-
Expenses in connection with the initial public offering	-	2,531
	736,180	21,157

DMI Administrative Services SA has at 31 December 2006 a potential contingent liability not exceeding $1.0 million in respect of its retirement benefit plan in the event that the plan assets attributable to individual members ultimately fall below their contractual entitlements.

Faysal Bank Limited carried at 31 December 2005 contingent liabilities of $450.1 million, of which the Group's share was $126.0 million. Faisal Private Bank (Switzerland) S.A. carried at 31 December 2005 contingent liabilities of $12.4 million, of which the Group's share was $6.1 million. These related to guarantees and letters of credit issued as part of their normal banking operations and customer claims. Both these companies have subsequently been reclassified as subsidiaries and their total contingent liabilities at 31 December 2006 have been included in the table above.

Faisal Islamic Bank of Egypt carried at 31 December 2005 contingent liabilities of $34.8 million, of which the Group's share was $3.5 million. These related to guarantees and letters of credit issued as part of their normal banking operations.

Meezan Bank Limited carried at 31 December 2006 contingent liabilities of $694.0 million, of which the Group's share was $104.1 million. These related to guarantees, letters of credit and other financing commitments made as part of their normal banking operations.

Sanpak Engineering carried at 31 December 2006 contingent liabilities of $1.8 million, of which the Group's share was $0.3 million. These related to letters of credit issued as part of their normal business activities.

Solidarity has at 31 December 2006 a letter of guarantee for $26.7 million (2005: $37.5 million), of which the Group's share is $10.7 million (2005: $15.0 million), from the National Commercial Bank of Saudi Arabia for the proposed incorporation of a subsidiary in the Kingdom of Saudi Arabia.

(Thousands of US dollars)

34. Contingent liabilities and commitments (continued)

Commitments	2006	2005
Undrawn facilities, financing lines and other commitments to finance	551,517	-

The Bank had a commitment at 31 December 2006 of Hong Kong dollars 279.9 million ($36.0 million) to pay the balance of the subscription monies due on the issue of 318,716,898 new shares in Citic International Assets Management Limited subject to calls being made by the directors over a period not exceeding two years from 28 December 2006.

On 21 September 2006 the Bank entered into an agreement to sell 7,500,000 shares in Solidarity Company B.S.C. (c) in exchange for $7.5 million. On the same date Islamic Investment Company of the Gulf (Bahamas) Limited agreed with the Bank that it would arrange to transfer 7,500,000 shares in Solidarity Company B.S.C. (c) to the purchaser under the agreement upon receipt of $7.5 million from the Bank. The transaction underlying the agreement was completed on 5 February 2007 when both the shares and the funds were transferred.

Operating lease commitments

Commitments for operating leases include IT hardware, cars and office equipment.

The future minimum lease payments under non cancellable operating leases are as follows:

Not later than one year	240	165
Later than one year and not later than five years	332	239
	572	404

Significant net open foreign currency position		
Trading	54,681	-

(Thousands of US dollars)

35. Concentration of assets and liabilities

Assets and liabilities of the Group are located in the following geographical regions and industry sectors:

	2006			2005		
Geographical regions	Assets	Liabilities	Contingent liabilities and commitments	Assets	Liabilities	Contingent liabilities and commitments
Asia	1,936,985	1,663,038	1,242,579	66,877	3,796	-
Middle East	501,411	442,487	115,761	117,390	31,025	17,724
Europe	653,200	74,295	5,090	219,941	105,108	1,306
North America	88,342	14,603	(20,492)	37,552	49,642	-
Other		677	11	588	-	-
	3,179,938	2,195,100	1,342,949	442,348	189,571	19,030

	2006			2005		
Industry sectors	Assets	Liabilities	Contingent liabilities and commitments	Assets	Liabilities	Contingent liabilities and commitments
Banks and finance institutions	1,516,751	767,706	393,238	344,234	161,045	17,069
Trading and manufacturing	286,198	143,441	153,177	23,136	9,403	274
Textiles	224,601	19,806	195,708			
Property and construction	267,670	91,647	62,552	48,238	3,087	404
Private individuals	321,481	664,128	82,425	3,337	936	-
Services	307,610	247,923	43,183	8,805	3,824	1,283
Chemical	40,461	20,960	65,180	325	-	-
IT & telecommunications	29,474	9,519	19,993	5,861	5,833	-
Oil & gas production	47,336	113,874	116,962	3,761	3,761	-
Utilities	50,901	2,845	32,737	698	1,207	-
Agriculture	35,802	27,062	3,307			
Other	51,653	86,189	174,487	3,953	475	-
	3,179,938	2,195,100	1,342,949	442,348	189,571	19,030

(Thousands of US dollars)

36. Maturities of assets and liabilities

The maturity profiles of assets and liabilities of the Group are as follows:

2006	Assets	Liabilities	Net liquidity gap
Up to 1 month	593,708	742,101	(148,393)
From 1 to 3 months	870,656	397,381	473,275
From 3 months to 1 year	398,802	604,890	(206,088)
From 1 to 5 years	656,950	55,576	601,374
From 5 years and over	659,822	395,152	264,670
	3,179,938	2,195,100	984,838

2005	Assets	Liabilities	Net liquidity gap
Up to 1 month	83,343	31,577	51,766
From 1 to 3 months	18,581	30,560	(11,979)
From 3 months to 1 year	35,628	20,052	15,576
From 1 to 5 years	203,654	80,209	123,445
From 5 years and over	101,142	27,173	73,969
	442,348	189,571	252,777

37. Currency exposure

2006	Assets	Liabilities	Net on balance sheet position	Contingent liabilities and commitments
United States Dollar	1,154,125	489,518	664,607	358,336
Pakistan Rupee	1,818,098	1,585,592	232,506	842,896
Swiss Franc	54,495	11,251	43,244	3,442
Saudi Rial	14,198	2,109	12,089	32,807
Bahrain Dinar	65,803	89,555	(23,752)	8,407
Egyptian Pound	9,748		9,748	
United Kingdom Pound	17,687	11,564	6,123	14,260
Euro	19,008	4,784	14,224	33,243
Other currencies	26,776	727	26,049	49,558
	3,179,938	2,195,100	984,838	1,342,949

(Thousands of US dollars)

37.Currency exposure (continued)

2005	Assets	Liabilities	Net on balance sheet position	Contingent liabilities and commitments
United States Dollar	306,839	173,096	133,743	7,507
Pakistan Rupee	66,877	-	66,877	-
Swiss Franc	37,714	5,723	31,991	1,306
Saudi Rial	2,059	517	1,542	10,217
Bahrain Dinar	419	-	419	-
Egyptian Pound	11,117	460	10,657	-
United Kingdom Pound	12,480	6,140	6,340	-
Euro	4,310	3,635	675	-
Other currencies	533	-	533	-
	442,348	189,571	252,777	19,030

38. Subsidiaries

A listing of the Group's principal subsidiaries is as follows:

	% owned		Country of
	Voting	Economic	Incorporation
Shamil Bank of Bahrain B.S.C.	60	60	Bahrain
Faysal Bank Limited	65	51	Pakistan
Faisal Private Bank (Switzerland) S.A.	100	79	Switzerland
Faisal Finance (Jersey) Limited	100	95	Jersey
Cantara (Switzerland) S.A.	100	100	Switzerland
DMI Administrative Services S.A.	100	100	Switzerland
DMI (Jersey) Limited	100	100	Jersey
MFAI (Jersey) Limited	100	100	Jersey
Faisal Finance (Luxembourg) S.A.	100	100	Luxembourg
Faisal Finance (Netherlands Antilles) NV	100	100	Netherlands Antilles
Rayten Holdings Limited	100	100	Jersey

Our People

Abdullah Nooraldin Al-Khateeb

Abdullah Salman Al-Ghatam

Ahmed M. Al-Dailami

Ali Jama Muse

Asfar Amanullah Mirza

Dana A. Raees

Feras Mohamed Al-Taleb

Hani Mahdi Nayem

Jaafar Ahmed Abul Hashem

Jayant Nadkarni

Jassim Abdulkareem Salman

Khalid Abdulla-Janahi

Khalil Mohammed Qamber

Luis Maronese

Maysan Al-Maskati

Michael McKinlay

Michael P. Lee

Mohammad Khan Hoti

Lulwa Yousif Al-Jassim

Nada Ahmed Al-A'ali

Nayla Asgharali

Sara Ahmedi

Scott A. Creswell

Sh. Salman bin Ahmed Al-Khalifa

Syed Altaf Azim

Syed Shahzad Bukhari

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