Brighter Banking

Annual Report 2006

BBK

بنك البحرين والكويت

www.bbkonline.com

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

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

Our Vision

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

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

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

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

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

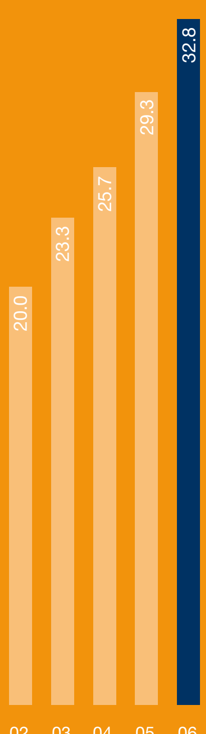
Brighter Banking

We are in business to enable people to build a wholly positive future based on greater financial autonomy at an individual, family and corporate level – the promise of a future that is fulfilling, secure and bright.

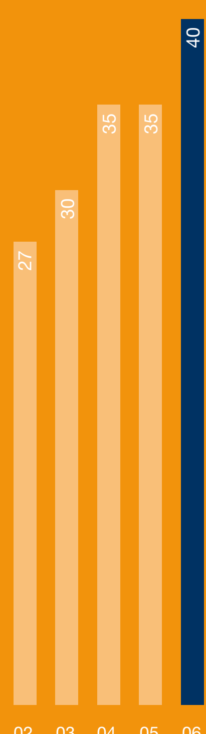
Contents


Harmonious

BBK has once again enjoyed a successful year characterised by significant strategic progress, strong financial performance, and substantial operational and organisational developments.

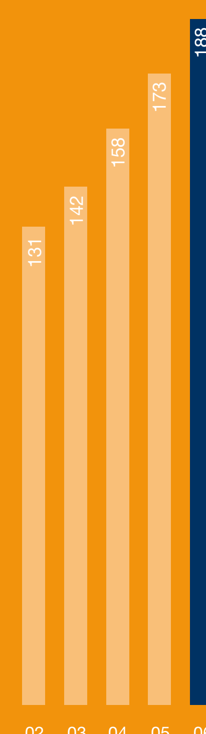


Net profit for the year
BD millions



Dividend
Per cent

Cost / Income
Per cent



Equity
BD millions

	2002	2003	2004	2005	**2006**
Income Statement Highlights (BD millions)					
Net interest income	25.5	26.1	29.5	35.7	**42.2**
Other income	16.2	21.4	23.6	20.2	**22.2**
Operating expenses	19.9	22.0	23.2	23.8	**26.7**
Net profit for the year	20.0	23.3	25.7	29.3	**32.8**
Dividend	27%	30%	35%	35%	**40%**
Financial Statement Highlights (BD millions)					
Total assets	1,215	1,314	1,421	1,499	**1,694**
Net loans	537	659	765	795	**938**
Investments	386	415	407	491	**495**
Deposits	760	823	890	917	**1,018**
Term loans	85	38	-	-	**-**
Medium term deposits from banks	-	47	94	94	**236**
Equity	131	142	158	173	**188**
Profitability					
Earnings per share (fils)	35	41	45	46	**52**
Cost / Income	47.70%	46.30%	43.70%	42.57%	**41.41%**
Return on average assets	1.66%	1.83%	1.83%	1.86%	**1.86%**
Return on average equity	16.10%	17.80%	17.80%	18.15%	**19.13%**
Profit per employee (BD)	28,341	32,739	36,578	41,837	**43,115**
Capital					
Capital adequacy	16.80%	16.73%	18.82%	19.57%	**16.20%**
Equity / Total assets	10.80%	10.80%	11.11%	11.55%	**11.08%**
Debt / Equity	64.70%	59.63%	59.73%	54.46%	**125.54%**
Liquidity and Business Indicators					
Loans & advances / Total assets	44.20%	50.20%	53.82%	53.04%	**55.38%**
Investments (excluding T bills) / Total assets	26.00%	25.70%	26.47%	31.14%	**26.87%**
Liquid assets / Total assets	34.10%	32.40%	29.42%	33.84%	**30.58%**
Non inter-bank deposits / Loans & investments	87.10%	86.04%	82.29%	76.46%	**86.69%**
Net yield ratio	2.45%	2.30%	2.29%	2.48%	**2.58%**
Number of employees	706	712	702	701	**761**

Chairman's Statement

Dear shareholders
On behalf of the Board of Directors, I am honoured to present the 35th annual report of BBK for the year ended 31st December 2006. I am very pleased to report that, once again, we have enjoyed a successful year characterised by significant strategic progress, strong financial performance, and substantial operational and organisational developments. In an increasingly competitive market, it is encouraging to witness our progress continuing to meet and exceed the high expectations of the first year of our three-year strategy.

Financial performance

In 2006, BBK recorded a net profit of BD 32.8 million, surpassing the previous year's record result of BD 29.3 million by BD 3.5 million or 12 per cent. Net income rose 15.3 per cent to BD 64.4 million, while operating expenses increased by BD 2.9 million (12.2 per cent) over 2005. The net provisions for the year, at BD 4.97 million, increased from BD 2.36 million in the previous year, as per the Bank's strategy of providing conservatively against its non-performing portfolio. On the other hand, the Bank continued with its strong focus on credit risk management and proactive remedial action.

Total assets grew by 13 per cent to BD 1,694 million, while shareholders' equity rose by 8.6 per cent to BD 188 million. BBK's consolidated profits have resulted in an increase in return on average equity, from 18.1 per cent in 2005 to 19.1 per cent in 2006. The Bank's market capitalisation stood at BD 444 million (or 700 fils per share) at the close of business on 31 December 2006.

Economic and market background

The region has undoubtedly been affected by the correction in the value of most of the GCC stock markets over the last year. This regional downturn affected Bahrain Stock Exchange, despite the improved performance of almost all local listed companies in 2006. Indeed, Bahrain's economy has remained buoyant, experiencing higher growth that is attributed to several factors: government and private investment in infrastructural projects; the strength of the industrial sector; and the Kingdom's pivotal position in the regional financial sector.

While oil production in the region remained high throughout 2006, the price did come down but still remained relatively high, contributing to enhanced liquidity levels and helping to sustain the region's current boom. The pace of diversification into non-oil industries – particularly the real estate market – has also increased over the last three years. In future, as new projects are completed, prices are expected to stabilise as supply rises to meet demand. Prospects for Bahrain and all the GCC economies remain very healthy.

It is hoped that the entry of high profile international hospitality chains will enhance the Kingdom's ability to handle increased levels of tourism and related business. BBK will continue to focus on satisfying the financial requirements that underpin the Kingdom's ambitious development of both infrastructure and commerce.

Despite being one of the biggest challenges, the Bank will maintain its proactive stance in providing opportunities to improve the supply and calibre of employees. Over the coming years, a higher level of economic growth coupled with the implementation of focused strategies will be needed to absorb young and newly qualified Bahrainis seeking employment. A number of initiatives have been introduced to address this issue. Whilst these are generating positive results, there remains a pronounced need for these activities to be sustained in the long-term in order for significant change to be achieved.

Strategic developments

During 2006 the Bank achieved growth across nearly all sectors, especially corporate banking. BBK Kuwait made a notable contribution to overall profitability, recording a substantial increase over previous years.

In Bahrain, an important development was the unveiling of our 'Financial Mall' one-stop banking concept. A first in the local market, the Financial Malls provide customers with an extended choice of strategically aligned products and services in conspicuous and convenient locations. The first two malls were inaugurated during the year, and ambitious plans include rolling out a further six during 2007.

In line with BBK's three-year strategy, we continued the programme of innovating and enhancing our array of retail products and services. Mortgage loans offering the best terms and repayment periods were introduced. Following the excellent market response and uptake, BBK has established itself as an attractive destination for such products.

On the corporate side, the Bank collaborated with two other local banks in a landmark transaction, providing a BD 100 million loan to Eskan Bank, formerly the Housing Bank of Bahrain.

Underpinning BBK's strategy of harnessing technological innovation to deliver improved customer services, a new Core Banking System was rolled out in January. A challenging and significant undertaking, the new system will greatly support the Bank's development and customer services in future years.

In January, BBK's call centre operations were spun off as a wholly owned company, Invita, which officially launched in November with state-of-the-art technology providing support and remote services, not only to the Bank and its subsidiaries, but also to third parties seeking professional call centre services. Furthermore, Sakana, a new joint venture in conjunction with Shamil Bank of Bahrain, was established to address the rising demand for Shari'a-compliant real estate financing.

Furthermore, BBK's Board of Directors reviewed during the year and approved plans to reactivate Al Khaleej Islamic Investment Bank (AKIIB). A new Board of Directors for AKIIB has been appointed and it will become operational once again in early 2007, focusing on providing Islamic financial solutions in this growing market.

Following the 2005 decision to divest BBK's branch network in India, the sale of the Indian operations could not be completed due to regulatory issues. The Board of Directors is currently evaluating longer term options and necessary action plans.

With the intention of effectively managing the liability side of the balance sheet, in March BBK became the first commercial bank in Bahrain to establish a US$ 1 billion Euro Medium Term Deposit Note (EMTDN) programme. Under this programme, the first issue of a five-year US$ 500 million bond was successfully completed, the largest ever issued by a Bahraini bank. The EMTDN was listed on the London Stock Exchange.

By mid 2006, the Board of Directors resolved to further enhance the transferability and liquidity of BBK shares by listing these in September on the Kuwait Stock Exchange.

Further evidence of enhanced performance and diversity was the upgrading of BBK's credit ratings by Moody's from Baa1 to A3, and by Fitch from BBB+ to A-. This recognition by the international agencies reflects increased investor confidence and has consolidated our position and performance in the region's banking community. The Bank's solid business growth in new areas and markets, its diversified revenue streams and the drive to build new competencies were also credited.

Corporate governance

Late in 2005 the Bahrain Monetary Agency (BMA) introduced new regulations for consumer lending, the effects of which were acutely felt on the Bank's consumer portfolio during 2006. In another regulatory development, the Central Bank of Bahrain (CBB) – which replaced the BMA during the year – revamped the Kingdom's licensing regulations. The new licensing framework more accurately reflects today's market environment and the resulting greater flexibility will stimulate heightened competition across Bahrain's banking and financial services sector.

A third area of regulatory change relates to risk management and capital adequacy. At present, BBK is undergoing a comprehensive review of all operational policies and procedures in preparation for the implementation of the Basel II Accords by the 2008 deadline.

Operational achievements

The most challenging operational accomplishment of 2006 was deployment of the new Core Banking System (CBS), regarded as the most sophisticated of its type in the region. Although there were some disruptions to customer service following the initial roll-out, in time the CBS will provide more efficient transaction processing, enhanced Customer Relationship Management (CRM) and Management Information System (MIS) capabilities, and improve the Bank's ability to respond quickly to the needs of customers. An effective platform to devise specifically customised solutions for differing customer segments was also put in place.

Organisational developments

Recognising people as our most important resource, ongoing training and personal development are high priorities within BBK. We remain committed to improving the quality and calibre of our manpower and to encourage the broadening of skills and knowledge. BBK will continue to be a market leader in the training area, particularly for university graduates.

Management techniques such as the 'balanced scorecard' and employee opinion surveys are proving useful tools in resource allocation and improving communication at all levels of the Bank. Succession planning continues to be a strategic initiative and we are prioritising the promotion of talent from as much as possible within BBK.

Corporate social responsibility

BBK continues in its efforts to enhance the social development and progression of the communities in which we operate. We are passionately committed to supporting a wide range of humanitarian, medical, social and educational initiatives through a sustained programme of charitable activities and donations. Programmes supported in 2006 included the Crown Prince's International Scholarship Fund (CPISF) to facilitate post-graduate education, and the Iqraa project to remodel an old Bahraini house into a library to encourage reading amongst the young.

Appreciations

On behalf of the Board, I would like to extend our appreciation and gratitude to His Majesty King Hamad bin Isa Al Khalifa, the King of Bahrain, and His Highness Sheikh Sabah Al Ahmed Al Jaber Al Sabah, the Amir of the State of Kuwait. I also thank their respective governments and regulatory authorities for their guidance and support during the year.

Finally, I would like to take this opportunity to express sincere thanks to our shareholders for their continued confidence, to our loyal customers for their patronage, and lastly to BBK's management and employees for their dedication and hard work throughout 2006.

Murad Ali Murad
Chairman

Award-winning

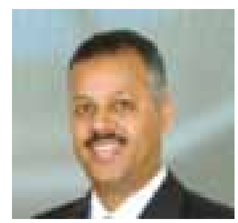
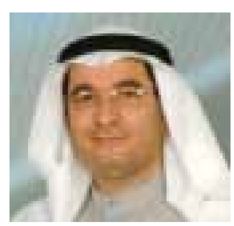
Board of Directors



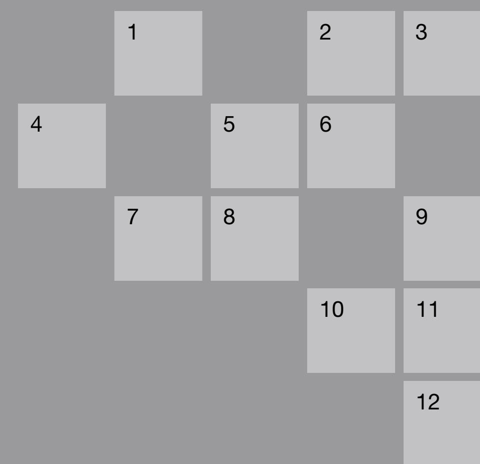






1 Murad Ali Murad
2 Jassem Hasan Ali Zainal
3 Yacoub Yousef Al Fulaij
4 Mohammed Salahuddin Ahmed
5 Hamad Ahmed Al Busairi
6 Abdulla Mohammed Al Sumait
7 Sh Mohammed bin Isa Al Khalifa
8 Aref Saleh Khamis
9 Jamal Ali Al Hazeem
10 Abdul Majeed Haji Al Shatti
11 Ali Hassan Meshari Al Bader
12 Sh Khalifa bin Daij Al Khalifa



Management Review

This year saw the commencement of BBK's ambitious new three-year strategic plan governing direction from 2006 to 2008. Based on achieving our overall vision, the plan builds on the progress achieved in recent years and is focused on advancing the Bank's evolution from a financially-focused to a people-centric organisation.

At the heart of BBK's evolution, two factors are fundamental in driving and embracing change – people and technology. We continue to invest heavily in both assets in order to introduce new retail and corporate banking products, and enhance our services to meet the increasing needs and expectations of the Bank's customers.

People

An essential element of our success is the strength and depth of relationships built between BBK's team of employees and our customers and suppliers. We are committed to enhancing the knowledge and experience of our team. This means that we will continue to encourage performance and personal development through ongoing training initiatives aimed at meeting the career objectives of every employee.

New management initiatives such as the introduction of the balanced scorecard, focus groups and the employee opinion survey are playing a fundamental role in shaping resource allocation, improving communication at all levels and guiding future direction in accordance with employee requirements.

Succession planning continues to be a strategic initiative. Priority is placed on promoting talent from within the Bank and rewarding individuals for their contribution to our success. Now in its third year, BBK's Management Trainee Programme is widely recognised as the most progressive graduate career development programme in the sector and it has set the benchmark for manpower training initiatives in Bahrain.

Clients

The financial sector in Bahrain is becoming an increasingly challenging and competitive environment. With changes in regulations and new international and regional players entering the market, BBK remains committed to maintaining its focus on product innovation through technology and enhanced service delivery.

2006 witnessed the contribution from ***retail banking*** activities increasing over the previous year. This was largely attributed to broadening the Bank's product offering and reducing our reliance on consumer lending following the changes in Central Bank of Bahrain (CBB) regulations that took effect in 2005.

The launch of our new 'Financial Malls' concept is poised to significantly strengthen BBK's retail stance. It enables us to augment our array of delivery channels so that customers may manage their finances entirely according to their preferences and convenience.

The first two Financial Malls opened during the year in Adliya and Budaiya and the next 12 months will see this network expand to eight locations. The concept goes further than traditional banking. It encompasses various value-added services including 24-hour electronic facilities through the *eZone* and offerings from strategic partners with insurance, telecommunications and housing solutions, all practically supported by extended opening hours and improved customer car parking.

Innovative


Passionate

The Bank's existing branch network has continued to undergo modernisation and the ATM network has been extended and enhanced with security measures such as anti-skimming devices and CCTV. We also introduced cash deposit machines that allow customers to make cash or cheque deposits, as well as paying credit card and utility bills.

BBK acted as lead manager for the IPO financing of Al Salam Bank, and as co-lead manager for Ithmar Bank's subscription. Both IPOs were received favourably by the market.

Following the changes in consumer lending regulations, a comprehensive mortgage loan product was developed that offers the highest loan amounts for nationals and expatriates alike, with the longest repayment periods. The enthusiastic uptake of this product has enabled BBK to take a market leading position in this important sector. A new loan facility was also developed for Al Hayrat Savings customers, offering new financing options of equal value to their investments, at highly competitive interest rates.

The Bank's achievements with regard to innovation and leadership in the online arena have been widely acknowledged. Two examples during the year saw BBK awarded at the Bahrain Web Awards in the banking category, as well as winning first place at the 3rd eBanking Middle East Award – Bahrain. The evolution of www.bbkonline.com is an ongoing initiative as more customers adopt online banking as their primary mode for conducting personal or business transactions.

In a new strategic alliance with Bahrain Post, we expanded the wholesale network for Western Union money transfers to 11 locations, providing customers with additional choice and convenience to make or receive remittances. The existing joint partnership with Bahrain & Kuwait Insurance Company (BKIC), the ***Secura*** portfolio of insurance products, remains important and 2006 saw various new marketing initiatives successfully launched.

BBK's wholly owned subsidiary ***CrediMax*** maintained its leadership in Bahrain's credit card market, achieving substantial growth by introducing new products for niche customer segments and strengthening ties with major merchants. Migration to a sophisticated new card management system was successfully conducted in 2006. This resulted in shortened processing cycles and enhanced quality of information to further improve customer service and drive product evolution.

The Bank's call centre operations were spun off into an independent, wholly owned company, branded ***Invita***, in early 2006. The company's core products include business process outsourcing, interactive (call centre) and non-interactive (back office processing) services, and IT services utilising Six Sigma methodology for process migration and management operations.

Sakana, the newly established joint venture between BBK and Shamil Bank of Bahrain, launched its operations in December. The company offers a range of Shari'a-compliant services that includes property financing, development, brokerage and management, catering to the rise in popularity of Islamic financial structures.

Strong growth in the ***corporate banking*** sector was once again witnessed in 2006. BBK was involved in almost all major infrastructure and industrial projects in the Kingdom, which included projects such as the expansion plans of Arab Shipbuilding and Repair Yard (ASRY) and Aluminium Bahrain (ALBA). Our involvement in financing Bahrain's burgeoning real estate sector included projects such as Pearl Island, Lulu Towers, Al Areen and the City Centre shopping mall.

Following liberalisation of the government's banking regulations, BBK was mandated by the Ministry of Finance to handle the accounts of Bahrain Customs and the Ministry of Electricity and Water. The Bank has also established a relationship with the newly founded Mumtalakat Company of Bahrain, a holding company that encompasses the commercial interests of Batelco, ASRY, GPIC, ALBA and others.

During 2006 ***international banking*** continued to grow BBK's offshore client base, actively participating in syndicated loans in its market domains and consolidating the growth in fee-based revenue emanating from the structured finance unit.

We successfully concluded, in alliance with Ahli United Bank and National Bank of Bahrain, a BD 100 million loan to Eskan Bank (formerly the Housing Bank of Bahrain), of which BBK's share was BD 33.3 million. BBK remained an active participant in GCC syndicated project finance transactions, including acting as one of the lead managers for Nakilat, a Qatar based company that owns, operates and leases a fleet of Liquified Natural Gas carriers as well as dry dock facilities.

At the beginning of the year the Bank conducted a series of roadshows across Europe, Asia and the Middle East to enlist support for BBK's highly successful US$ 500 million debut Euro Medium Term Deposit Note (EMTDN) issue under an established US$ 1 billion EMTDN programme. The EMTDN was listed on the London Stock Exchange in March. BBK's shares were listed on the Kuwait Stock Exchange in September. These achievements enhance BBK's name in the international debt market as well as strengthening its balance sheet structure.

Strong and stable performance from ***treasury and investmen***t activities continued to manage the interest rate and liquidity risks of the balance sheet in compliance with the Bank's policies and financial objectives. Contribution from this area to the net income has materially increased, through various investment and trading activities. These activities included, new investment products, improving service quality and strengthening relationships with external partners – all of which aimed at further consolidating our market-leading position and building a solid platform for future expansion.

BBK serves the needs of customers abroad through its branches in Kuwait and India, and its Dubai representative office in the United Arab Emirates. Operating in an increasingly competitive market – which saw the entry of four major international banks during 2006 – ***BBK Kuwait*** maintained its competitive edge through effective tactical campaigns and promotions focusing on specific market segments and quality asset prioritisation.

2006 was a record year for ***BBK Dubai*** in terms of new assets booked, total assets and profitability. Performing loans registered significant growth and the branch diversified its asset base across new sectors with high quality borrowers. Financing was arranged for two significant projects in the hospitality and energy sectors and BBK participated in innovative structures including Shari'a-compliant financings and convertible sukuks.

BBK India experienced a year of consolidation in line with the Board's decision to evaluate strategic options for the Bank's representation in the sub-continent. Efforts were made to stabilise the customer base and attention was paid to reducing the number of non performing assets.

Internal processes

Key internal developments of the year included stabilisation of the new core banking system and re-establishing the interfaces of various IT platforms. 2006 also saw the 'balanced scorecard' implemented as a key performance tracking and management tool, and the overhaul of the inter-departmental cost allocation and revenue sharing methodology, to better reflect the performance contribution of each department and customer.

Since the segregation of the credit review function from the Business Units in 2001 – in line with Basel II – a robust system of independent review of each credit has been developed. The function was further refined in 2006 with added emphasis on risk / return due diligence, facility structures and verifying the accuracy of borrowers' risk grades. This will be an ongoing initiative that ensures total compliance with Basel II standards by the 2008 deadline. It will also serve as a platform for introducing a Foundation Internal Rating Based (FIRB) approach in the longer term.

BBK continues to review all internal processes and policies to ensure adherence to the Board of Directors' directives. It also closely monitors conformance to all CBB regulations. Reports on these and various other issues are submitted to the Board of Directors on a quarterly basis, reviewing and monitoring change within BBK.


Reliable


Fresh

The focus of banking operations activities throughout the year was on compliance with internal and CBB regulations, and preparing for the implementation of the Basel II guidelines. A significant achievement was the upgrading of 450 clients from manual payroll processing to automated ledgers. This involved identifying those that would benefit from such a system, the subsequent installation of dedicated payroll software, and training programmes conducted at many clients' premises.

Technology

Implementation of the new Core Banking System (CBS) in 2006 was a very challenging activity due to the complexities of our core banking environment. Ongoing post migration review, refinement and modification delivered a number of features with tangible benefits. In addition, an automated anti-money laundering system was deployed, upgraded and integrated with the new CBS.

Community

In 2006 BBK maintained its support of social development and progress in the communities that we serve. Every year a wider range of humanitarian, medical, scientific, cultural, educational, environmental, sporting and social organisations benefit from the Bank's active support and financial assistance. To date, over BD 4.5 million has been donated through our programme of charitable activities and donations.

We are firmly committed to initiating and partnering in activities for the overall good of society, the focal point of which is the development of Bahrain's people and communities, especially in rising to the significant challenges of the future.

In summary, 2006 proved to be a year of considerable achievement. Encouraging progress was achieved in transforming BBK from a traditional financially-focused institution into a more agile people-centric organisation. Of course, BBK's accomplishments are largely attributed to the remarkable commitment and efforts of its team. Through our employees' willingness to embrace change, we are realising the Bank's vision and we will continue to build on BBK's past successes to provide our shareholders with future growth and prosperity.

Dr Farid Ahmed Al Mulla
General Manager Chief Executive Officer

Executive Management

From left to right
Abdul Hussain Bustani
Vinit Kohli
Dr Farid Ahmed Al Mulla
Ian Mackay
Jamal Mohammed Hijres
Abdul Karim Ahmed Bucheery

From left to right
Abdulla Abdulrahman Hussain
Mahmood Abdul Aziz
Reyadh Yousif Sater
Ahmed Ali Al Banna
Amit Kumar
Adnan A. Wahab Al Arayyed

Financial Review

This review incorporates the consolidated operating results and the consolidated balance sheet of BBK with its overseas branches, its principal subsidiaries, Credimax and Invita, and the joint venture Sakana Holistic Housing Solutions. The consolidated financial statements have been prepared and presented in accordance with International Financial Reporting Standards, and are in conformity with Bahrain Commercial Companies Law and Central Bank of Bahrain and Financial Institutions law.

Operating results

The Bank has shown a consistently strong operating performance for the year ended 31 December 2006. Despite incurring additional expenses on developing new businesses and providing prudently for impaired assets, the net operating profits for the year, attributable to the shareholders of the parent, rose to BD 32.8 million, an increase of BD 3.5 million or 11.9 per cent compared with the previous year. Strong revenue growth across all major business activities contributed to the improved performance. As a result, the return on average equity also improved to 19.13 per cent from 18.15 per cent a year ago.

Operating income

Total operating income rose to BD 64.4 million from BD 55.9 million in 2005, representing an increase of BD 8.5 million or 15.2 per cent. The improvement in income was driven by growth in core business revenue streams, such as net interest income and fees and sundry income.

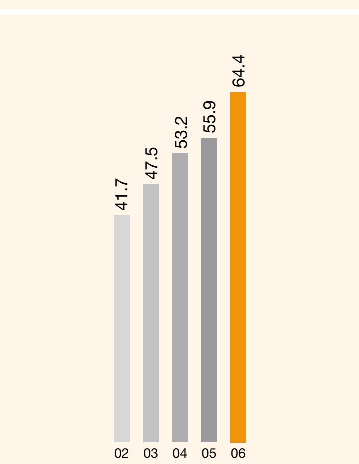
Net interest income

Net interest income for the year grew sharply from BD 35.7 million to BD 42.2 million, an increase of 18.3 per cent, reflecting a strong underlying growth in business volume. The total balance sheet of the Bank grew by 13.0 per cent during the year, supported by impressive growth of 18.0 per cent in net customer loans. Despite the Bank's prudent policies on credit, interest and liquidity risk, the net yield improved further to 2.58 per cent, from 2.48 per cent in 2005.

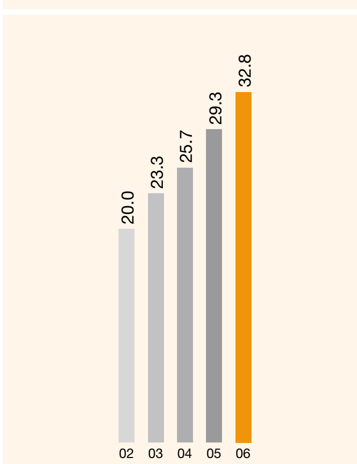
Summary Income Statement

BD millions	2006	2005	Variance BD millions	Change Percent
Net interest income	**42.2**	35.7	6.5	18.17%
Other income	**22.2**	20.2	2.0	10.03%
Total income	**64.4**	55.9	8.5	15.29%
Operating expenses	**26.7**	23.8	2.9	12.22%
Provisions	**4.9**	2.4	2.5	107.54%
Profit before taxation	**32.8**	29.7	3.1	10.26%
Taxation	**0.0**	-0.4	0.4	-94.26%
Net profit for the year	**32.8**	29.3	3.5	11.88%

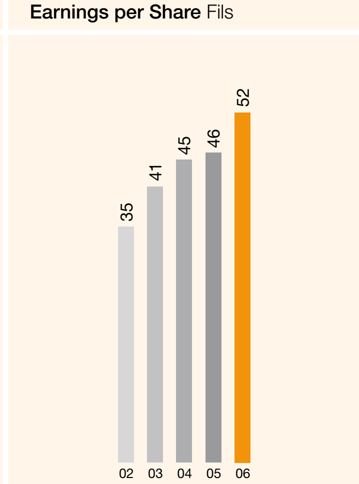
Total Income BD millions



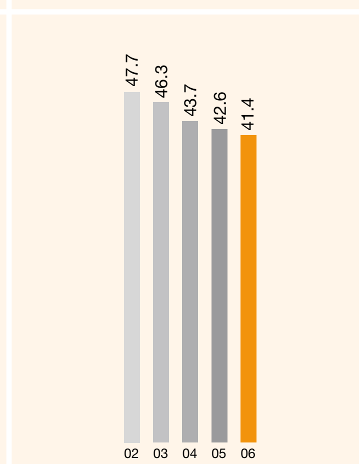
Net Profit BD millions



Earnings per Share Fils



Cost / Income Per cent



Other income
Other operating income includes non-interest income, which is earned from business activities such as dealing in foreign currencies, investment in funds, the sale of corporate banking and retail banking services, and share of profit / loss in associated company and joint venture. The total income generated during the year from these core activities was BD 22.2 million, which was 10 per cent higher than the previous year.

Fees and commission earned grew by BD 2.2 million or 20 per cent, mainly due to higher income from the Bank's credit card business, commercial services fees, and corporate and retail banking fees.

Operating expenses
Total operating expenses, which include staff, premises, equipment depreciation and other administrative costs, increased by BD 2.9 million (12.2 per cent) as the Bank made investment in human resources, infrastructure and development of new businesses, in line with the new 2006–08 corporate strategy now being implemented.

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

The net provisions for the year, at BD 4.97 million, increased from BD 2.4 million in the last year as the Bank continued its strategy to provide aggressively against its non-performing portfolio as a prudent measure.

Financial position
The balance sheet of the Bank at the year end was BD 1,694 million, reflecting an increase of 13.0 per cent over year end 2005. The average balance sheet for the year at BD 1,764 million was 12 per cent higher than the corresponding figure for the last year. At the year end, over 11 per cent of the balance sheet was funded by equity, with the rest coming from customers and medium-term deposits.

Consolidated Balance Sheet

BD millions	2006	2005	Variance BD millions	Change Percent
Assets				
Cash and balances with central banks	**55.4**	49.7	5.7	11.50%
Treasury bills	**39.8**	23.8	16.0	67.18%
Deposits and due from banks and other financial institutions	**164.1**	130.7	33.4	25.54%
Loans and advances to customers	**938.1**	795.0	143.1	18.00%
Non-trading investment securities	**445.6**	457.5	-11.9	-2.60%
Investment in associated company and joint venture	**9.5**	9.3	0.2	2.46%
Interest receivable and other assets	**22.4**	16.0	6.4	39.92%
Premises and equipment	**18.9**	16.8	2.1	12.44%
Total Assets	**1,693.8**	1,498.8	195.0	13.01%
Liabiliites and Equity				
Liabilities				
Deposits and due to banks and other financial institutions	**263.8**	238.2	25.5	10.71%
Borrowings under repurchase agreements	**16.4**	102.0	-85.6	-83.90%
Medium term deposits from banks	**235.6**	94.3	141.4	150.00%
Customers' current, savings and other deposits	**963.9**	863.4	100.5	11.64%
Interest payable and other liabilities	**26.1**	27.5	-1.4	-4.97%
Total Liabilities	**1,505.8**	1,325.4	180.4	13.61%
Equity attributable to shareholders of the parent	**187.7**	173.1	14.6	8.45%
Minority Interest	**0.3**	0.3	-0.1	-
Total equity (before appropriations)	**188.0**	173.4	14.6	8.40%
Total Liabilities and Equity	**1,693.8**	1,498.8	195.0	13.01%

Assets

The year end loans and advances to customers, at BD 938 million, were 18 per cent higher than the previous year. The average portfolio of loans at BD 888 million was also higher by 13.0 per cent than the average for the year 2005. The growth in loans and advances was in corporate lending, mainly in Bahrain and Dubai.

The investment portfolio of the Bank is classified into three categories: "Held for Trading", "Available for sale", and "Investments stated at amortised cost". They consist of quoted bonds, equities and unquoted securities that are mainly acquired with the intention of being retained for the long term. At the end of 2006, 30.73 per cent of these investments were in the form of quoted bonds and equities (32.73 per cent at the end of 2005).

Non-trading investment securities decreased marginally by 2.59 per cent, mainly due to reduced investment in government bonds (2005: grew sharply by over 21 per cent, mainly because of growth in investment in quoted bonds, government bonds and other bonds).

Investment in associated company and joint venture represents the Bank's 20.25 per cent interest in the equity of Bahrain Commercial Facilities Company, a public shareholding company, and its investment in Sakana Holistic Housing Solutions B.S.C. (c). The carrying value of this investment represents the Bank's share in the total shareholders' equity of the companies.

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

Liabilities

Current, saving and other deposits include balance of interest-bearing and non interest-bearing accounts due to customers on demand, and term deposits taken with different maturity dates, in various currencies and at varying rates of interest. As at year end, customer deposits increased to BD 963.9 million from BD 863.4 million at the end of 2005, showing growth of 11.6 per cent.

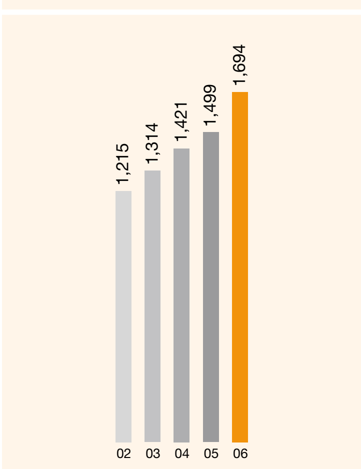
During the year, the Bank has issued floating rate deposit notes amounting to US$ 500 million as part of its US$ 1 billion Euro Medium-Term Deposits Notes programme. These notes are issued for 5 years, and carry a coupon of 3 months LIBOR plus 45 bps. At year end, the Bank also had US$ 125 million of medium-term deposits from banks after repaying a similar amount. The objective of sourcing medium-term funds was to diversify sources of funds for growing the balance sheet, and continuously improving the maturity structure of the Bank's balance sheet.

Interest payable and other liabilities consist of accrued interest payable on interest-bearing deposits, accrued expenses, and provisions.

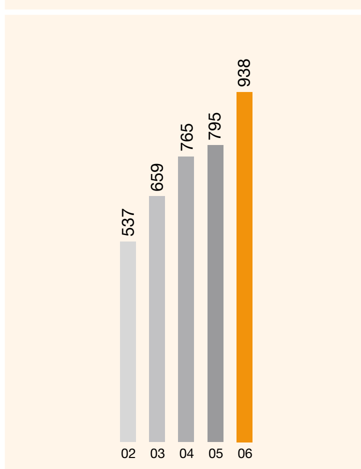
Capital adequacy

Equity before appropriations increased to BD 187.7 million at the end of 2006 from BD 173.1 million at end of the previous year, further strengthening the financial position of the Bank. Despite aggressive growth in customer advances and other risk weighted assets, the Bank's capital adequacy ratio at end of 2006 stood at 16.2 per cent, which is well above the 8 per cent minimum required by the Basel Accord. This ratio measures total qualifying capital held by a bank in relation to its risk-weighted assets and contingents. The Central Bank of Bahrain increased this minimum requirement to 12 per cent with effect from 1998 for locally incorporated banks.

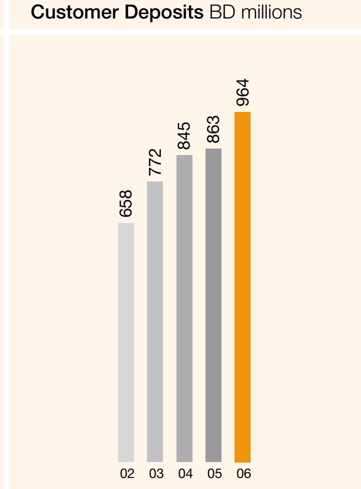
Total Assets BD millions



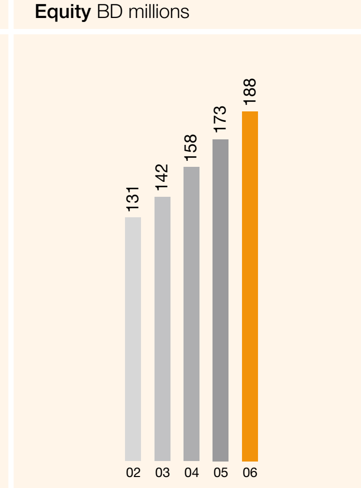
Loans and Advances BD millions



Customer Deposits BD millions



Equity BD millions




Attentive

Risk Management

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

In common with other financial institutions, the Bank faces a range of risks in its business and operations. These include: (i) credit risk; (ii) market risk (including interest rate risk, currency risk and equity price risk); (iii) liquidity risk; and (iv) legal and operational risk, as detailed below.

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

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

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

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

The various risks to which the Bank is exposed and how the Bank manages them individually are set out below:

Credit risk

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

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

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

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

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

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

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

In order to concentrate on recovering non-performing loans and advances, experienced and skilled staff manage them under separate recovery / loan work-out sections within the Retail and Corporate Banking Divisions.

Liquidity risk

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

The Bank has in place a liquidity risk policy, which describes the roles and responsibilities of ALMC and Treasury, and stipulates the broad guidelines with regard to minimum liquid assets to be maintained by the Bank. The Bank uses a maturity ladder (time buckets) approach for managing its liquidity. The limits for the funding requirement for each time bucket of the maturity ladder; the cumulative outflow of cash for each time bucket; and various liquidity ratios to be maintained are approved by the ALMC based on the Annual Liquidity Strategy.

It is the Bank's policy to keep its assets in high-quality liquid assets such as inter-bank placements, Treasury Bills and Government Bonds, to ensure that funds are available to meet maturing liabilities, un-drawn facilities and deposit withdrawals. A substantial proportion of the Bank's deposits is made up of retail current, savings and fixed deposit accounts which, though payable on demand or at short notice, have traditionally formed part of a stable deposit base and a source of core funding.

The day to day management of liquidity risk is the responsibility of the Global Treasurer. He monitors the sources and maturities of assets and liabilities closely and ensures that limits stipulated by the ALMC are complied with, and that funding is not concentrated from any one source.

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

Interest rate risk

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

It is the Bank's policy to keep its assets and liabilities mismatches at stable and acceptable levels to maintain steady net interest income. The Bank monitors interest rate risk based on gap / duration limits. The Bank also uses 'what if' scenarios for changes, if any, in interest rates, for projecting net interest income as also economic value of equity of the Bank. The Bank uses derivative instruments such as interest rate swaps, floating rate agreements and bond futures to manage interest rate risk. Whilst day to day management of interest rate risk is the Global Treasurer's responsibility, ALMC also reviews the interest rate risk reports periodically.

Market risk

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

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

10 day VaR – January to December 2006

The Bank uses an internal Value-at-Risk (VaR) model for measuring general market risk. The internal model was approved by the Central Bank of Bahrain. VaR is calculated using a 99 per cent confidence level for a 10-day holding period. This implies a 1 per cent possibility of the loss exceeding the VaR amount calculated by the model. As at 31st December 2006, VaR calculated based on the above parameters was BD 105,279 (US$ 279,202).

A graph of VaR for the year 2006 is given on the previous page. The graph depicts the 10-day horizon VaR movement for each day.

The Risk Management Department conducts backtesting in accordance with the Market Risk Capital Adequacy Regulations issued by the Central Bank of Bahrain. Backtesting involves comparing the one-day daily VaR with the average daily profit and loss (i.e. average of that day and the next day profit and loss). The objective is to ensure that the assumptions used for computing VaR are reasonable and provide a VaR number that is a good indicator of worst possible losses. A graph showing backtesting is given below.

During the year the backtesting produced satisfactory results, indicating that the assumptions used in computing VaR have been reasonable. The Bank also regularly conducts stress testing to identify events or scenarios that could greatly impact material trading positions taken by the Bank. As per Central Bank of Bahrain requirements, validation of the internal model is conducted by the Internal Audit Department of the Bank as well as by the external auditors.

Legal risk

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

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

Operational risk

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

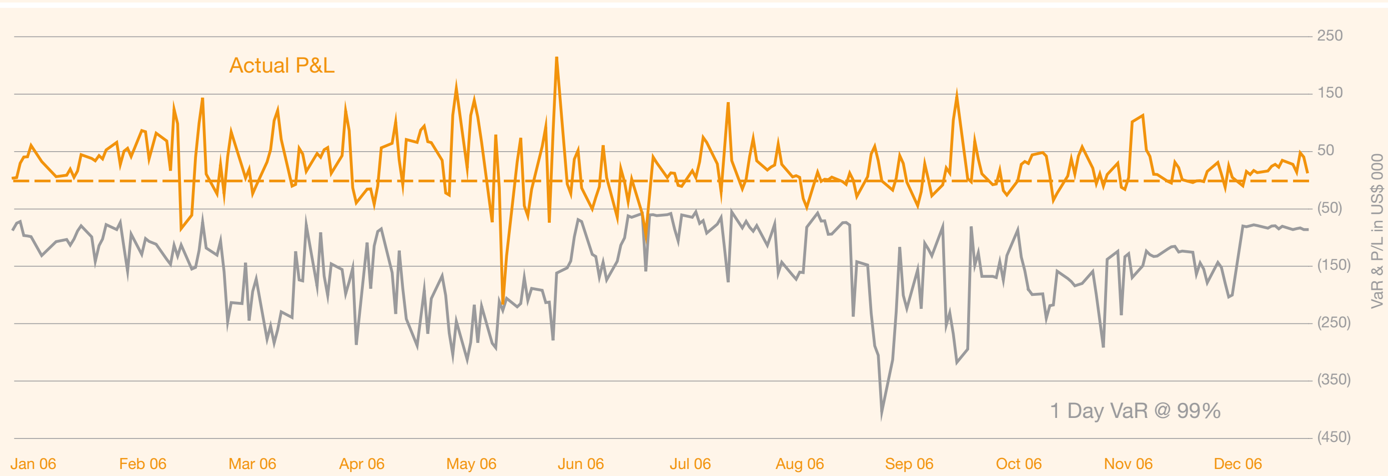
All computer systems and operations procedures are approved by the Internal Audit Department. This department operates independently from other units of the Bank and reports directly to the Audit Committee, which consists of members of the Board. It conducts regular reviews of all business areas of the Bank and reports control deficiencies and exceptions to the Bank's policies and procedures. It also recommends measures to improve operational risk, which are implemented by management immediately.

The Bank also has a contingency plan to take care of any failure of its computer systems. Regular back-ups are made for all important datasets, and stored outside the Bank's premises. This ensures that in case of any system failure, the Bank will be able to continue its operations without losing critical data or business transactions. As part of its disaster recovery plan, the Bank has established a back-up site to stand in and operate during an emergency.

The Bank has a specific Business Continuity Plan (BCP) unit. The main objective of the BCP is to ensure that in the event of full or partial disaster, the Bank should be able to continue providing essential services to customers, minimizing any adverse effects on the Bank's business, through, business impact analysis, business restoration plans and procedures, for the identified critical functions.

The Bank is in the process of implementing a comprehensive operational risk management framework, in accordance with Basel II / Central Bank of Bahrain guidelines.

Backtesting VaR – January to December 2006



Corporate Governance and Additional Disclosures

A. Shareholder information

BBK's shares are listed on the Bahrain and Kuwait stock exchanges. The Bank has issued 640,195,312 equity shares with a face value of 100 fils. All shares are fully paid.

Annual General Meeting

The Annual General Meeting of the shareholders was held on 26 February 2006 and two Extraordinary Meetings were held on 26 February and 18 March 2006.

Shareholders

Name	Nationality	No. of shares	% holding
Bahrain Citizens & Others	-	129,234,582	20.19
Pension Fund Commission	Bahraini	120,265,817	18.79
General Organization for Social Insurance(GOSI)	Bahraini	85,447,968	13.35
Bank of Kuwait and the Middle East (BKME)	Kuwaiti	43,213,175	6.75
Commercial Bank of Kuwait (CBK)	Kuwaiti	124,123,235	19.39
Kuwait Investment Projects Co. Asset Management(Portfolio)	Kuwaiti	41,645,000	6.50
Kuwait Investment Projects Co. Asset Management	Kuwaiti	32,895,333	5.13
Group Securities Co.	Kuwaiti	26,559,000	4.15
Kuwait Investment Authority	Kuwaiti	24,007,314	3.75
Kuwait International Investment Co.	Kuwaiti	12,803,888	2.00

Distribution schedule of each class of equity (as at 31 December 2006)

Category	No. of shares	No. of shareholders	% of outstanding shares
Less than 1%	129,234,582	2,385	20.19
1% to less than 5%	63,370,202	3	9.9
5% to less than 10%	117,753,508	3	18.39
10% to less than 20%	329,837,020	3	51.52
20% to less than 50%	-	-	-
50% and above	-	-	-

B. Board of Directors information

Corporate governance philosophy

High standards in corporate governance are fundamental in maintaining BBK's leading position within the local and regional banking sector and the community. Continuous review and adherence to strong corporate governance practices help enhance compliance levels according to international standards and best practice. As the direct responsibility of the Board of Directors, this endeavour is in line with the policies of regulatory authorities and statutory requirements in the Kingdom of Bahrain and other countries where BBK operates.

Directors' roles and responsibilities

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

The Board of Directors meets not less than four times a year. Currently, the Board comprises twelve non-executive Directors, including the Chairman.

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

Directors' remuneration

The Directors' remuneration, allowances and expenses for attendance at Board meetings and its Committees for 2006 were BD 492,974 (2005: BD 528,296).

Directors' profiles

Mr Murad Ali Murad
Chairman
Director since 21 March 1999 (Independent)
Board Member – Bahrain Telecommunications Co.
Board Member – Bahrain Commercial Facilities Co. (B.S.C.)
Board Member – Bahraini Kuwaiti Insurance Co.
Deputy Chairman – Eskan Bank
Deputy Chairman – Al-Banader Hotel Co.
Board Member – Bahrain Mumtalakat Holding Co.
Board Member – Umniah Mobile Co., Jordan
Member – Council of Vocational Training in Banking Sector
Chairman – Human Resources Development Fund in Banking Sector

Mr Jassem Hasan Ali Zainal
Deputy Chairman
Director since 22 November 1994 (Independent)
Chairman & Managing Director of Zumorroda Investment for Asset Management Co.
Deputy Chairman – Al-Razi Holding Co.
Deputy Chairman & Managing Director – Addax Investment Bank
Board Member – Kuwait Real Estate Bank

Mr Yacoub Yousef Al Fulaij
Director since 28 March 1994 (Independent)
Board Member – National Bank of Kuwait

Mr Mohammed Salahuddin Ahmed
Director since 1 May 1990 (Independent)
Chairman – Mohammed Salahuddin Consulting Engineering Bureau
Board Member – Bahrain Water Bottling and Beverages Co.
Board Member – Sunni Waqf Directorate
Board Member – Bahrain Businessmen's Association
Board Member – Intershield W.L.L.

Mr Hamad Ahmad Al Busairi
Director since 11 January 2001 (Independent)
Senior Investment Manager – Kuwait Investment Authority
Board Member – Tunisi Kuwaiti Bank

Mr Abdulla Mohammed Al Sumait
Director since 22 April 2001 (Independent)
Deputy Chief General Managers – Al Ahli Bank of Kuwait
Board Member – Union of Kuwaiti Banks

Sh Mohammed bin Isa Al Khalifa
Director since 4 December 2002
Director General – General Organization for Social Insurance (commencing 18/01/2007)
First Deputy Chairman – Bahrain Telecommunications Co.
Chairman – Securities and Investment Co.
Board Member – Bahrain Commercial Facilities Co.
Deputy Chairman – National Motor Co.
Deputy Chairman – Bahrain International Golf Course Co.

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

Mr Jamal Ali Al Hazeem
Director since 27 February 2005 (Independent)
Board Member – Nass Group
Board Member – Al-Tameer Co.

Mr Abdul Majeed Haji Al Shatti
Director since 24 March 2004
Chairman & Managing Director – Commercial Bank of Kuwait
Board Member – National Technology Enterprises Co.

Mr Ali Hassan Meshari Al Bader
Director since 27 February 2005 (Independent)
Chairman – Strategia Investment Co.

Sh Khalifa bin Daij Al Khalifa
Director since 27 February 2005 (Independent)
President – Court of the Crown Prince
Board Member – Bahrain International Circuit

Board Secretary: Mr Saad Mohammed Al Hooti

Code of conduct

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

Insider trading

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

Board meetings and attendances

During 2006 nine Board meetings were held in Bahrain. The quarterly meetings were attended as follows:

26/2/2006	18/6/2006	29/10/2006	24/12/2006
Mr Murad Ali Murad	Mr Murad Ali Murad	Mr Murad Ali Murad	Mr Murad Ali Murad
Mr Jassem Hasan Ali Zainal	Mr Jassem Hasan Ali Zainal	Mr Jassem Hasan Ali Zainal	Mr Yacoub Yousef Al Fulaij
Mr Yacoub Yousef Al Fulaij	Mr Yacoub Yousef Al Fulaij	Mr Mohammed Salahuddin Ahmed	Mr Mohammed Salahuddin Ahmed
Mr Hamad Ahmed Al Busairi	Mr Mohammed Salahuddin Ahmed	Mr Abdulla Mohammed Al Sumait	Mr Hamad Ahmed Al Busairi
Mr Abdulla Mohammed Al Sumait	Mr Hamad Ahmed Al Busairi	Mr Hamad Ahmed Al Busairi	Sh Mohammed bin Isa Al Khalifa
Sh Mohammed bin Isa Al Khalifa	Mr Abdulla Mohammed Al Sumait	Sh Mohammed bin Isa Al Khalifa	Mr Aref Saleh Khamis
Mr Aref Saleh Khamis	Sh Mohammedd bin Isa Al Khalifa	Mr Aref Saleh Khamis	Mr Abdul Majeed Haji Al Shatti
Mr Abdul Majeed Haji Al Shatti	Mr Aref Saleh Khamis	Mr Abdul Majeed Haji Al Shatti	Mr Jamal Ali Al Hazeem
Mr Jamal Ali Al Hazeem	Mr Jamal Ali Al Hazeem	Mr Jamal Ali Al Hazeem	Mr Ali Hassan Al Bader
Mr Ali Hassan Al Bader	Mr Ali Hassan Al Bader	Mr Ali Hassan Al Bader	
Mr Mohammed Salahuddin Ahmed			

Directors' interests

The number of shares held by the Directors and their related parties as at 31 December 2006:

Director	Type of shares	31st Dec 2005	31st Dec 2006
Mr Murad Ali Murad	Ordinary	238.000	267,750
Mr Mohammed Salahuddin Ahmed	Ordinary	204,655	315,361
Mr Jassem Hasan Ali Zainal	Ordinary	100,000	112,500
Mr Abdulla Mohammed Al Sumait	Ordinary	100,000	112,500
Mr Ali Hassan Al Bader	Ordinary	100,000	112,500
GOSI / Sh Mohammed bin Isa AlKhalifa	Ordinary	None	100,000
Mr Abdul Majeed Haji Al Shatti	Ordinary	None	100,000
Pension Fund Com. / Mr Aref Khamis (**)	Ordinary	None	100,000
Mr Hamad Ahmed Al Busairi	Ordinary	None	100,000
Mr Jamal Ali Al-Hazeem	Ordinary	None	112,500

(**) Qualifying shares related is part of the whole shares of the ownership.

Related parties

Al Janabeya Co. WLL owns 16,875 shares.

Material contracts involving Directors

Provision of consultancy services by Mohammed Salahuddin Consultancy Engineering Bureau (MSCEB) for the Financial Malls project. Contract value: BD 43,196 (as at 31 December 2006).

Board committees

Committee	Members	Summary terms of reference
Executive Committee	Mr Yacoub Yousef Al Fulaij (Chairman) Sh Mohammed bin Isa Al Khalifa (Deputy Chairman) Mr Jassem Hasan Ali Zainal Mr Aref Saleh Khamis Mr Hamad Ahmed Al Busairi Mr Mohammed Salahuddin Ahmed	• Six members are appointed for a 1 year term. • Minimum number of meetings required each year: 10 (actual meetings in 2006: 11) • Role: reviews, approves and directs the Executive Management on matters raised to the Board of Directors.
Audit Committee	Mr Murad Ali Murad (Chairman) Mr Abdulla Mohammed Al Sumait Mr Abdulmajeed Haji Al Shatti Mr Jamal Ali Al Hazeem Sh Khalifa bin Daij Al Khalifa	• Five members are appointed for 1 year term. • Minimum number of meetings required each year: 4 (actual meetings in 2006: 4). • Role: reviews the internal audit programme and internal control system, considers the major findings of: internal audit review, investigations and management's response, as well as, ensuring coordination among internal and external auditors.
Insiders Committee	Mr Murad Ali Murad (Chairman) Mr Abdulla Mohammed Al Sumait Mr Abdulmajeed Haji Al Shatti Mr Jamal Ali Al Hazeem Sh Khalifa bin Daij Al Khalifa	• Five members are appointed for a 1 year term. • Minimum number of meetings required each year: 4 (actual meetings in 2006: 4) • Role: tracks, monitors and reports trading activities of insiders in accordance with stipulation of CBB on Insiders.
Compensation Committee	Mr Murad Ali Murad (Chairman) Mr Jassem Hasan Ali Zainal Mr Hamad Ahmed Al Busairi Mr Aref Saleh Khamis	• Four members are appointed for a 1 year term. • Minimum number of meetings required each year: 2 (actual meetings in 2006: 6) • Role: establishes a broad compensation policy of the Directors and Executive Management.

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

C. Executive management information

Leadership

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

Executive management profiles

Dr Farid Ahmed Al Mulla
General Manager Chief Executive Officer
Education: PhD in Economics and International Relations, University of Sussex, UK (1982).
Experience: 24 years banking experience. Date of joining BBK: 1990.

Mr Ahmed Ali Al Banna
Deputy General Manager, Banking Group
Education: BSc, University of Houston, US (1978).
Experience: 23 years banking experience. Date of joining BBK: 1987.

Mr Jamal Mohammed Hijris
Assistant General Manager, Retail Banking
Education: MBA, University of Bahrain, Bahrain (1991).
Experience: 28 years banking experience. Date of joining BBK: 1979.

Mr Abdul Hussain Bustani
Assistant General Manager, Human Resources and Administration
Education: Higher National Diploma (Civil Engineering), Trent University, UK (1978).
Experience: 19 years banking experience. Date of joining BBK:1988.

Mr Abdulla Abdulrahman Hussain
Assistant General Manager, Information Technology
Education: MBA, University of Bahrain, Bahrain (1994).
Experience: 19 years IT experience. Date of joining BBK: 2002.

Mr Abdul Karim Ahmed Bucheery
Assistant General Manager – Corporate and International Banking
Education: BSc, University of Aleppo, Syria (1976).
Experience: 29 years banking experience. Date of joining BBK: 2002.

Mr Ian Mackay
Assistant General Manager – Treasury and Investment
Education: PhD in Economics, University of Manchester UK – 1974
Experience: 33 years of banking experience. Date of joining BBK: 2006.

Mr Reyadh Yousif Sater
Assistant General Manager, Internal Audit
Education: MBA, University of Glamorgan, UK (2001).
Experience: 29 years banking experience. Date of joining BBK: 1978.

Mr Amit Kumar
Senior Manager, Risk Management
Education: MBA, India Institute of Management, India (1983).
Experience: 23 years banking experience. Date of joining BBK: 1994.

Mr Adnan A. Wahab Al Arrayed
Senior Manager, Credit Management
Education: BSc, Beirut Arab University, Lebanon (1984).
Experience: 25 years banking experience. Date of joining BBK: 1983.

Mr Vinit Kohli
Chief Financial Officer, Financial Control and Planning
Education: BCom, Delhi University, India.
CA, Institute of Chartered Accountants of India.
Experience: 25 years experience. Date of joining BBK: 2002.

Mr Mahmood Abdul Aziz
Senior Manager, Operations
Education: Executive Management Diploma, University of Bahrain, Bahrain.
Gulf Executive Management Program, University of Virginia, US.
Experience: 35 years' banking experience. Date of joining BBK: 1976.

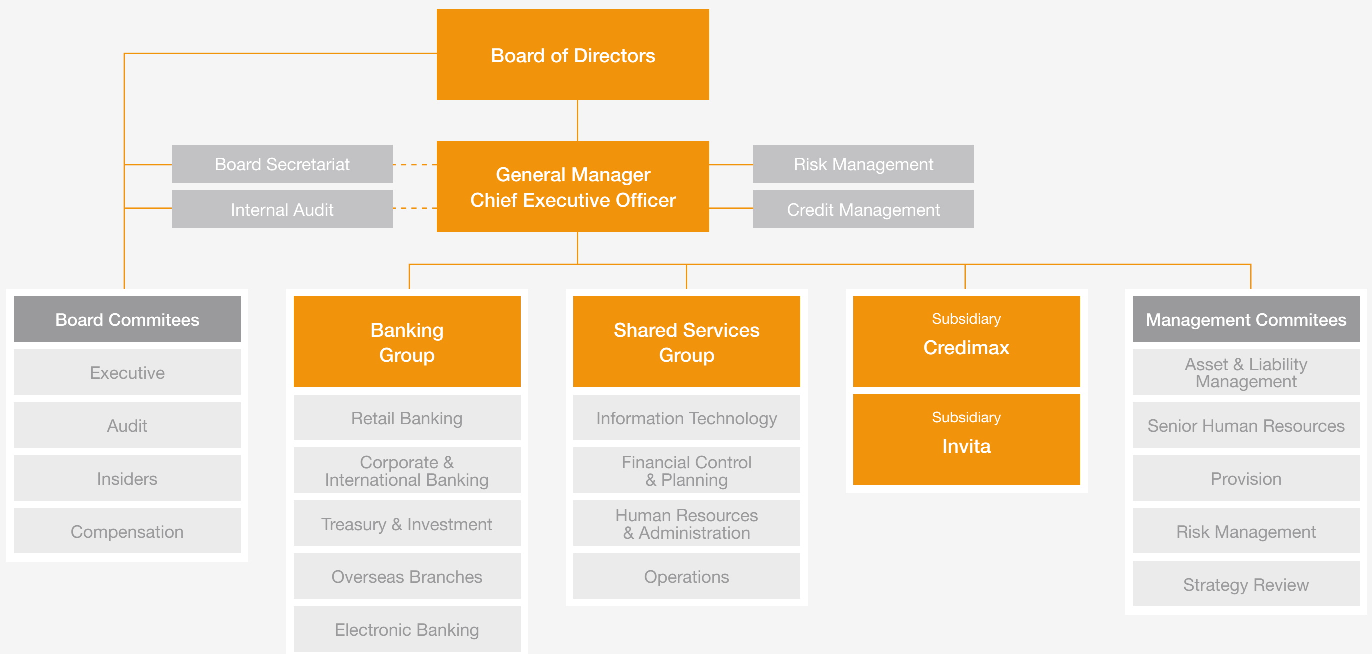
Executive management committees

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

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

D. Other information

Organisational structure



Note: Business Development Division, formerly under Banking Group has been reorganised with its duties assigned to other units of the Bank.

Compliance and anti-money laundering

Compliance with regulatory and statutory requirements is an ongoing process. The Bank is conscious of its responsibilities in observing all regulatory provisions and best international practices in its functioning. The Bank has an established Compliance Unit in keeping with Basel and CBB guidelines and it acts as a focal point for regulatory compliance and other best practice compliance principles. Anti-Money Laundering measures form an important area of the function, in addition to areas of corporate governance, disclosure standards, adherence to best practices, and conflict of interest.

The Bank has documented an Anti-Money Laundering and Combating Terrorist Financing Policy and Procedure, which contains sound Customer Due Diligence measures, procedures for identifying and reporting suspicious transactions, and a programme for periodic awareness training to staff, record-keeping, and a designated Money Laundering Reporting Officer. The Bank has also taken initiatives in deploying and upgrading a risk based automated transaction monitoring system in keeping with Anti-Money Laundering Regulations of CBB. The Bank has taken all other initiatives in keeping with the comprehensive Anti-Money Laundering Regulations of CBB.

The Bank's Anti-Money Laundering measures are audited by independent external auditors every year, and their report is submitted to the CBB. The overseas branches in India and Kuwait and subsidiary (Credimax) have designated compliance and MLRO functions to ensure implementation of local regulations, and also to meet CBB requirements as applicable.

The Bank is committed to combating money laundering and, towards this end, implements all 'Prevention of Money Laundering Regulations' and other guidelines issued by the CBB. These regulations and guidelines are consistent with the revised FATF 49 recommendations, 'Customer Due Diligence for Banks' paper, and best international practices.

While a number of internal processes were refined during the year to ensure compliance of various product offerings, regrettably the Bank was fined by the CBB for not responding within a given period to a query regarding the installation of some security related devices. The problem was largely attributed to a delay incurred with a third party vendor and all outstanding issues were resolved to the CBB's complete satisfaction.

Stock incentive scheme

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

Communication strategy

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

Major BBK shareholdings

Company	% holding
Bahrain Telecommunications Company (Batelco)	2.40%
Bahrain Credit Facilities Company	20.25%
Securities and Investment Company (SICO)	8%
Bahrain Kuwait Insurance Company (BKIC)	6.83%
Sakana Holistic Housing Solutions	50%

Contact directory

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

BBK – Kuwait
Ahmed Al Jaber Avenue
PO Box 24396, 13104 Safat, Kuwait
Telephone: +965 241 7140
Fax: +965 244 0937

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

BBK – Hyderabad
6-3-550 L B Bhavan, Somajiguda
Hyderabad 500482, India
Telephone: +9140 339 8219
Fax: +9140 337 5977

BBK – Dubai Representative Office
Creek Tower, Office No. 18A
PO Box 31115, Dubai, UAE
Telephone: +9714 221 0560 / 221 0570 / 223 7156
Fax: +9714 221 0260

Subsidiaries

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

Invita
Suite 107, Building 128,
Road 383, Block 316, Manama Center.
PO Box 597, Manama, Bahrain.
Telephone: +973 17 50 6000
Fax: +973 17 91 9231
www.invita.com.bh

Independent Auditors' Report to the Shareholders

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

Board of Directors' Responsibility for the Financial Statements

The Board of Directors 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 consolidated 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.

Auditors' 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the consolidated 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 consolidated financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2006 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Regulatory Matters

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements, and the contents of the Chairman's statement relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank, have occurred during the year ended 31 December 2006 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position, and that the Bank has complied with the terms of its banking licence.

Ernst & Young

4 February 2007
Manama, Kingdom of Bahrain

Consolidated Financial Statements

Consolidated Balance Sheet

31 December 2006

	Notes	2006 BD '000	2005 BD '000
ASSETS			
Cash and balances with central banks	4	**55,455**	49,686
Treasury bills	5	**39,784**	23,806
Trading investments		**-**	10
Deposits and due from banks and other financial institutions		**164,117**	130,713
Loans and advances to customers	6	**938,042**	795,006
Non-trading investment securities	7	**445,623**	457,476
Investment in associated company and joint venture	8	**9,522**	9,272
Interest receivable and other assets	9	**22,335**	16,009
Premises and equipment	10	**18,888**	16,799
TOTAL ASSETS		**1,693,766**	1,498,777
LIABILITIES AND EQUITY			
LIABILITIES			
Deposits and due to banks and other financial institutions		**263,758**	238,242
Borrowings under repurchase agreements	11	**16,418**	102,003
Medium term deposits from banks	12	**235,625**	94,250
Customers' current, savings and other deposits		**963,884**	863,400
Interest payable and other liabilities	13	**26,123**	27,489
TOTAL LIABILITIES		**1,505,808**	1,325,384
EQUITY			
Share capital	14	**64,019**	56,906
Treasury stock	14	**(1,357)**	(1,357)
Statutory reserve	15	**29,788**	26,507
General reserve	15	**20,000**	20,000
Cumulative changes in fair values	16	**31,658**	29,650
Foreign currency translation adjustments		**146**	(391)
Retained earnings		**13,783**	13,899
Proposed appropriations	17	**29,645**	27,850
EQUITY ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**187,682**	173,064
Minority interests		**276**	329
TOTAL EQUITY		**187,958**	173,393
TOTAL LIABILITIES AND EQUITY		**1,693,766**	1,498,777

The consolidated financial statements were authorised for issue in accordance with a resolution of the directors on 4 February 2007.

Murad Ali Murad
Chairman

Jassem Hasan Ali Zainal
Deputy Chairman

Dr Farid Ahmed Al Mulla
General Manager Chief Executive Officer

The attached notes 1 to 38 form part of these consolidated financial statements.

Consolidated Income Statement

Year ended 31 December 2006

	Notes	2006 BD '000	2005 BD '000
Interest income	18	**105,374**	74,616
Interest expense	19	**63,145**	38,906
Net interest income		**42,229**	35,710
Share of profit in associated company and joint venture	8	**1,037**	1,571
Other income	20	**21,165**	18,605
		64,431	55,886
Staff costs		**15,054**	13,347
Other expenses		**9,720**	8,415
Depreciation		**1,909**	2,030
Net provision for impairment on loans and advances to customers	6	**5,280**	2,449
Net (write back) for impairment of non-trading investment securities	7	**(315)**	8
Total operating expenses		**31,648**	26,153
PROFIT BEFORE TAXATION		**32,783**	29,733
Taxation (write back)/ provision - Indian Branches		**(120)**	453
Kuwait National Labour support tax		**146**	-
NET PROFIT FOR THE YEAR		**32,757**	29,280
Attributable to:			
SHAREHOLDERS OF THE PARENT		**32,810**	29,328
Loss attributable to minority interests		**(53)**	(48)
		32,757	29,280
BASIC AND DILUTED EARNINGS PER SHARE (BD)	21	**0.052**	0.046

The attached notes 1 to 38 form part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

Year ended 31 December 2006

		Attributable to shareholders of the parent									Minority interest	Total equity
	Notes	Share capital BD '000	Treasury stock BD '000	Statutory reserve BD '000	General reserve BD '000	Cumulative changes in fair values BD '000	Foreign currency translation adjustments BD '000	Retained earnings BD '000	Proposed appropriations BD '000	Total BD '000	BD '000	BD '000
Balance at 31 December 2004		56,906	(1,053)	23,574	20,000	22,926	(508)	15,354	20,624	157,823	-	157,823
Foreign exchange translation adjustments		-	-	-	-	-	117	-	-	117	-	117
Approval of directors' remuneration and donations for 2004		-	-	-	-	-	-	-	(860)	(860)	-	(860)
Net movement in cumulative changes in fair values	16	-	-	-	-	6,724	-	-	-	6,724	-	6,724
Total income and expense for the year recognised directly in equity		-	-	-	-	6,724	117	-	(860)	5,981	-	5,981
Net profit for the year – 2005		-	-	-	-	-	-	29,328	-	29,328	(48)	29,280
Total income and expense for the year		-	-	-	-	6,724	117	29,328	(860)	35,309	(48)	35,261
Approval of dividend for 2004		-	-	-	-	-	-	-	(19,764)	(19,764)	-	(19,764)
Purchase of treasury stock		-	(304)	-	-	-	-	-	-	(304)	-	(304)
Minority interest in share capital of subsidiary		-	-	-	-	-	-	-	-	-	377	377
Transfer to statutory reserve		-	-	2,933	-	-	-	(2,933)	-	-	-	-
Proposed directors' remuneration	17	-	-	-	-	-	-	(390)	390	-	-	-
Proposed donations	17	-	-	-	-	-	-	(600)	600	-	-	-
Proposed dividend	17	-	-	-	-	-	-	(19,747)	19,747	-	-	-
Proposed issue of bonus shares	17	-	-	-	-	-	-	(7,113)	7,113	-	-	-
Balance at 31 December 2005		**56,906**	**(1,357)**	**26,507**	**20,000**	**29,650**	**(391)**	**13,899**	**27,850**	**173,064**	**329**	**173,393**
Month end average equity – 2005												**161,614**

The attached notes 1 to 38 form part of these consolidated financial statements.

Consolidated Statement of Changes in Equity continued

Year ended 31 December 2006

	Notes	Attributable to shareholders of the parent									Minority interest	Total equity
		Share capital BD '000	Treasury stock BD '000	Statutory reserve BD '000	General reserve BD '000	Cumulative changes in fair values BD '000	Foreign currency translation adjustments BD '000	Retained earnings BD '000	Proposed appropriations BD '000	Total BD '000	BD '000	BD '000
Balance at 31 December 2005		56,906	(1,357)	26,507	20,000	29,650	(391)	13,899	27,850	173,064	329	173,393
Foreign exchange translation adjustments		-	-	-	-	-	537	-	-	537	-	537
Approval of directors' remuneration and donations for 2005		-	-	-	-	-	-	-	(990)	(990)	-	(990)
Net movement in cumulative changes in fair values	16	-	-	-	-	2,008	-	-	-	2,008	-	2,008
Total income and expense for the year recognised directly in equity		-	-	-	-	2,008	537	-	(990)	1,555	-	1,555
Net profit for the year – 2006		-	-	-	-	-	-	32,810	-	32,810	(53)	32,757
Total income and expense for the year		-	-	-	-	2,008	537	32,810	(990)	34,365	(53)	34,312
Approval of dividend for 2005		-	-	-	-	-	-	-	(19,747)	(19,747)	-	(19,747)
Issue of bonus shares		7,113	-	-	-	-	-	-	(7,113)	-	-	-
Transfer to statutory reserve		-	-	3,281	-	-	-	(3,281)	-	-	-	-
Proposed directors' remuneration	17	-	-	-	-	-	-	(455)	455	-	-	-
Proposed donations	17	-	-	-	-	-	-	(600)	600	-	-	-
Proposed dividend	17	-	-	-	-	-	-	(25,389)	25,389	-	-	-
Proposed issue of bonus shares	17	-	-	-	-	-	-	(3,201)	3,201	-	-	-
Balance at 31 December 2006		**64,019**	**(1,357)**	**29,788**	**20,000**	**31,658**	**146**	**13,783**	**29,645**	**187,682**	**276**	**187,958**
Month end average equity – 2006												171,505

Retained earnings include BD 8,938 thousand (2005 11,164 thousand) of non - distributable reserves.

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

The attached notes 1 to 38 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

Year ended 31 December 2006

	Notes	2006 BD '000	2005 BD '000
OPERATING ACTIVITIES			
Profit before taxation		**32,783**	29,733
Adjustments for:			
Net provisions (write backs) relating to:			
Loans and advances to customers	6	**5,280**	2,449
Non-trading investment securities	7	**(315)**	(88)
Share of profit in associated company and joint venture	8	**(1,037)**	(1,571)
Depreciation		**1,909**	2,030
Realised (gains) on sale of investments		**(1,555)**	(1,699)
Kuwait National Labour support tax		**(146)**	-
Taxation - write back/(provision) - Indian branches		**120**	(453)
Operating profit before working capital changes		**37,039**	30,401
(Increase) decrease in operating assets:			
Mandatory reserve deposits with central banks		**853**	(4,456)
Treasury bills maturing after 91 days		**-**	5,503
Trading investments		**10**	(8)
Deposits and due from banks and other financial institutions		**37,063**	10,158
Loans and advances to customers		**(148,316)**	(32,766)
Interest receivable and other assets		**(6,459)**	(3,948)
Increase (decrease) in operating liabilities:			
Deposits and due to banks and other financial institutions		**25,516**	9,390
Borrowings under repurchase agreements		**(85,585)**	29,827
Customers' current, savings and other deposits		**100,484**	18,898
Interest payable and other liabilities		**(1,366)**	4,272
Net cash (used in) from operating activities		**(40,761)**	67,271
INVESTING ACTIVITIES			
Purchase of non-trading investment securities		**(217,056)**	(375,210)
Disposal and maturities of non-trading investment securities		**232,896**	301,452
Dividends received from associated company	8	**810**	810
Investment in joint venture	8	**-**	(2,500)
Purchase of premises and equipment		**(3,998)**	(4,249)
Net cash from (used in) investing activities		**12,652**	(79,697)
FINANCING ACTIVITIES			
Repayment of medium term deposits from banks	12	**(47,125)**	-
Issue of Euro Medium Term Deposit Notes	12	**188,500**	-
Purchase of treasury stock		**-**	(304)
Minority interest in share capital of subsidiary		**-**	377
Payment of dividend, directors' remuneration and donations	17	**(20,737)**	(20,624)
Net cash from (used in) financing activities		**120,638**	(20,551)
Foreign currency translation adjustments		**537**	117
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**93,066**	(32,860)
Cash and cash equivalents at beginning of the year		**142,353**	175,213
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	23	**235,419**	142,353

The attached notes 1 to 38 form part of these consolidated financial statements.

1 ACTIVITIES

BBK B.S.C (the Bank), a public shareholding company, was incorporated in the Kingdom of Bahrain by an Amiri Decree in March 1971 and registered with the Ministry of Industry and Commerce under Commercial Registration (CR) number 1234 dated 16 March 1971. The Bank operates in Bahrain under a commercial banking license issued by the Central Bank of Bahrain (formerly the Bahrain Monetary Agency). The Group is engaged in commercial banking activities through its branches in Bahrain, Kuwait and India, credit card operations and business process outsourcing services through its subsidiaries. The Bank's registered office is at 43 Government Avenue, P O Box 597, Manama, Kingdom of Bahrain.

2 BASIS OF CONSOLIDATION

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

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

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

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

3 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of consolidated financial statements are consistent with those used in previous year and are set out below:

Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), and are in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law.

Basis of presentation

The consolidated financial statements are prepared under the historical cost convention as modified by the re-measurement at fair value of derivatives and trading and available-for-sale investment securities. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and are otherwise carried at cost, are adjusted to record changes in fair values attributable to risks that are being hedged.

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

Trading investments

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

Deposits and due from banks and other financial institutions

These are stated at cost, adjusted for effective hedges, less any amounts written off and provision for impairment.

Loans and advances to customers

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

3 SIGNIFICANT ACCOUNTING POLICIES continued

Non-trading investment securities
These are classified as follows:

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

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

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

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

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

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

That portion of any fair value changes relating to an effective hedging relationship is recognised directly in the consolidated income statement.

Impairment and uncollectability of financial assets
An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, any impairment loss, is recognised in the consolidated income statement.

Impairment is determined as follows:

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

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

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

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

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

Derecognition of financial assets and financial liabilities
Financial Assets
A financial asset (in whole or in part) is derecognised where:

- the right to receive cash flow from the asset have expired;
- the Group has transferred its rights to cash flows from an asset and either (a) has transferred substantially all the risks and rewards of ownership or (b) when it has neither transferred or retained substantially all the risks and rewards and when it no longer has control over the financial asset, but has transferred control of the asset.

3 SIGNIFICANT ACCOUNTING POLICIES continued

Financial Liability
A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Fair values

For financial instruments traded in an active market, fair value is determined by reference to quoted market bid prices for assets and quoted market offer prices for liabilities.

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

- brokers' quotes
- recent transactions
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics
- option pricing models
- net asset values from the fund managers

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

Investment in associated company and joint venture

An associate is a company in which the Group exerts significant influence, normally comprising an interest of 20% - 50% in the voting capital and is accounted for using the equity method of accounting. A joint venture is a contractual arrangement whereby Group undertake an economic activity with other entity(s) that is subject to joint control. Joint venture is also accounted for using the equity method of accounting.

Premises and equipment

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

Collateral pending sale

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

Deposits

All money market and customer deposits are carried at the fair value of consideration recieved, adjusted for effective hedges, less amounts repaid.

Repurchase and resale agreements

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

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

Taxation

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

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

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

3 SIGNIFICANT ACCOUNTING POLICIES continued

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

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

Treasury stock
Treasury stock is stated at cost.

Proposed dividend
Proposed dividends are included as part of equity and only recognised as liabilities when approved by the shareholders.

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

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

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

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

For hedges which do not qualify for hedge accounting, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated income statement for the year.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. For effective fair value hedges of financial instruments with fixed maturities any adjustment arising from hedge accounting is amortised over the remaining term to maturity. For effective cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated income statement.

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

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

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

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

3 SIGNIFICANT ACCOUNTING POLICIES continued

Revenue recognition continued

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

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

Foreign currencies

Translation of foreign currency transactions

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

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

Translation of financial statements of foreign entities

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

Cash and cash equivalents

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

Trade date accounting and settlement date accounting

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

Significant accounting judgments and estimates

Judgments

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

Classification of investments

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

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

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

All other investments are classified as available for sale.

Estimation assumptions

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

Impairment losses on loans and advances and investments

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

Collective impairment provisions on loans and advances

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

3 SIGNIFICANT ACCOUNTING POLICIES continued

New Standards and Interpretations not yet effective

The following standards have been issued but not effective

		Effective from
IFRS 7	Financial Instruments: Disclosures	1 January 2007
IFRS 8	Operating Segments	1 January 2009
IAS 1	Amendment – Capital Disclosures	1 January 2007

All these amendments only impact disclosures and will be effective as indicated above.

4 CASH AND BALANCES WITH CENTRAL BANKS

	2006 BD '000	2005 BD '000
Cash	**7,869**	7,885
Current account and placements with central banks	**24,717**	18,080
Mandatory reserve deposits with central banks	**22,869**	23,721
	55,455	49,686

5 TREASURY BILLS

These are short term treasury bills issued by the Government of the Kingdom of Bahrain and are carried at amortised cost.

6 LOANS AND ADVANCES TO CUSTOMERS

	2006 BD '000	2005 BD '000
Commercial loans	**678,196**	541,666
Consumer loans	**112,833**	113,721
Overdrafts	**144,891**	139,448
Credit cards	**27,535**	27,148
Other	**21,970**	22,381
	985,425	844,364
Less: Provision for impairment and interest in suspense	**(47,383)**	(49,358)
	938,042	795,006

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

(i) Industry sector

	2006 BD '000	2005 BD '000
Trading and manufacturing	**307,711**	273,710
Banks and other financial institutions	**121,999**	83,553
Construction and real estate	**166,104**	103,689
Government and public sector	**64,700**	76,553
Individuals	**207,735**	210,714
Others	**117,176**	96,145
	985,425	844,364
Less: Provision for impairment and interest in suspense	**(47,383)**	(49,358)
	938,042	795,006

6 LOANS AND ADVANCES TO CUSTOMERS continued

(ii) Geographical region

	2006 BD '000	2005 BD '000
Gulf Co-operation Council countries	**924,812**	781,502
European Union countries	**18,858**	8,941
Asia	**39,872**	51,558
Others	**1,883**	2,363
	985,425	844,364
Less: Provision for impairment and interest in suspense	**(47,383)**	(49,358)
	938,042	795,006

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

	2006				2005
	3 months to 1 year BD '000	**1 - 3 years BD '000**	**Over 3 years BD '000**	**Total BD '000**	Total BD '000
Gross non-performing loans	**14,287**	**1,598**	**52,408**	**68,293**	68,378
Less: Provisions				**(33,347)**	(35,278)
Less: Interest in suspense				**(11,684)**	(11,691)
Net outstanding				**23,262**	21,409

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

	2006 BD '000	2005 BD '000
Balance at 1 January	**49,358**	58,625
Charge for the year	**7,374**	8,909
Recoveries / write-backs	**(2,094)**	(6,460)
Interest suspended during the year, net	**1,850**	1,584
Amounts written off during the year, net	**(7,567)**	(12,369)
Interest recognised on impaired loans	**(875)**	(868)
Exchange and other movements	**(663)**	(63)
Balance at 31 December	**47,383**	49,358

d) As of 31 December 2006, gross loans and advances to customers which were classified as impaired amounted to BD 68.3 million (2005 BD 68.4 million). The total of provisions carried and the value of securities held for these loans amounted to BD 99.7 million (2005 BD 100.7 million).

e) As of 31 December 2006, the balance of restructured loans amounted to BD 24.9 million (2005 BD 8.9 million). The majority of restructuring relates to extending the period of repayments. The restructured loans have no material impact on the current year's earnings and are not expected to have a material adverse effect on future earnings.

7 NON-TRADING INVESTMENT SECURITIES

	Available-for-sale BD '000	Carried at amortised cost BD '000	**Total 2006 BD '000**	Total 2005 BD '000
Quoted investments				
Equities	31,436	-	**31,436**	31,429
Bonds	105,523	-	**105,523**	118,292
Managed funds	6,353	-	**6,353**	9,803
	143,312	-	**143,312**	159,524
Unquoted investments				
Government bonds	-	163,727	**163,727**	167,729
Other bonds	30,204	73,856	**104,060**	95,330
Equities	17,514	-	**17,514**	14,654
Managed funds	12,545	-	**12,545**	17,357
Others	1,291	5,655	**6,946**	7,156
	61,554	243,238	**304,792**	302,226
	204,866	**243,238**	**448,104**	461,750
Provision for impairment	(2,481)	-	**(2,481)**	(4,274)
Balance at 31 December 2006	**202,385**	**243,238**	**445,623**	
Balance at 31 December 2005	212,448	245,028		457,476

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

	Available-for-sale BD '000	Carried at amortised cost BD '000	**Total 2006 BD '000**	Total 2005 BD '000
Balance at 1 January	3,331	943	**4,274**	4,405
Charge for the year	171	-	**171**	427
Recoveries / write-backs	(439)	(47)	**(486)**	(515)
Amounts written off during the year	(581)	(895)	**(1,476)**	-
Exchange and other movements	(1)	(1)	**(2)**	(43)
Balance at 31 December	2,481	-	**2,481**	4,274

Included under available-for-sale investments are unquoted investments amounting to BD 42.1 million (2005 BD 41.1 million) which are carried at cost. This is due to the unpredictable nature of their future cash flows and the lack of suitable alternate methods for arriving at a reliable fair value.

8 INVESTMENT IN ASSOCIATED COMPANY AND JOINT VENTURE

The Group has a 20.25% (2005 20.25%) shareholding in Bahrain Commercial Facilities Company B.S.C. (BCFC), incorporated in the Kingdom of Bahrain. During 2005 the Group had taken a 50 % stake in Sakana Holistic Housing Solutions B.S.C. (c), a newly incorporated jointly controlled company incorporated in the Kingdom of Bahrain which is engaged in Islamic real estate financing. The following tables illustrate summarised financial information of the Group's interest in these entities:

8 INVESTMENT IN ASSOCIATED COMPANY AND JOINT VENTURE *continued*

	2006 BD '000	2005 BD '000
Carrying amount of investment in associate and joint venture		
At 1 January	**9,272**	5,812
Investment in joint ventures	**-**	2,500
Share of results	**1,037**	1,571
Dividends paid	**(810)**	(810)
Change in unrealised fair values -associated company (Note 16)	**23**	199
At 31 December	**9,522**	9,272
Share of associate and joint venture balance sheet:		
Current and non current assets	**30,351**	26,378
Current and non current liabilities	**20,829**	17,106
Net assets	**9,522**	9,272
Share of associate and joint venture revenue:		
Revenue	**2,818**	3,177

The results and balance sheet of BCFC are for the twelve month period ended 30 September being the latest available information. The results and balance sheet of Sakana Holistic Housing Solutions B.S.C. (c) are for the thirteen month period ended 31 December 2006.

9 INTEREST RECEIVABLE AND OTHER ASSETS

	2006 BD '000	2005 BD '000
Interest receivable	**11,165**	8,508
Collateral pending sale	**828**	828
Accounts receivable	**3,102**	1,000
Positive fair value of derivatives (Note 25)	**1,332**	1,254
Advance tax	**771**	716
Deferred tax	**119**	-
Prepaid expenses	**1,083**	638
Other	**3,935**	3,065
	22,335	16,009

10 PREMISES AND EQUIPMENT

	Free hold land BD '000	Lease hold properties and building BD '000	Furniture and equipment BD '000	Capital work in progress BD '000	Total BD '000
Cost	**6,982**	**13,179**	**18,622**	**863**	**39,646**
Accumulated Depreciation	**-**	**7,105**	**13,653**	**-**	**20,758**
Net book value at 31 December 2006	**6,982**	**6,074**	**4,969**	**863**	**18,888**
Net book value at 31 December 2005	6,288	5,862	4,085	564	16,799

The depreciation charge for the year amounted to BD 1.9 million (2005 BD 2 million).

11 BORROWINGS UNDER REPURCHASE AGREEMENTS

The proceeds from assets sold under repurchase agreements, at the year-end, amounted to BD 16.4 million (2005 BD 102 million). The assets sold under repurchase agreements were non trading investment securities of the Group amounting to BD 16.2 million (2005 BD 101.6 million).

12 MEDIUM TERM DEPOSITS FROM BANKS

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

Amount of facility US$ '000	Rate of interest	Maturity (Year)	Carrying amount 2006 BD '000	Carrying amount 2005 BD '000
125,000	Libor + 0.485%	2006	**-**	47,125
125,000	Libor + 0.425% to 2007	2009	**47,125**	47,125
	Libor + 0.450% from 2008			
500,000	Libor + 0.450%	2011	**188,500**	-
			235,625	94,250

During the year, the Bank issued unsecured floating rates deposit notes amounting to US $ 500 million as part of its US $ 1 billion Euro Medium Term Deposits Notes Programme.

13 INTEREST PAYABLE AND OTHER LIABILITIES

	2006 BD '000	2005 BD '000
Interest payable	**6,569**	8,554
Accounts payable	**6,189**	5,730
Accrued expenses	**11,816**	11,856
Negative fair value of derivates (Note 25)	**451**	207
Other	**1,098**	1,142
	26,123	27,489

14 SHARE CAPITAL AND TREASURY STOCK

	2006 BD '000	2005 BD '000
Share Capital		
Authorised:		
1,000,000,000 shares of BD 0.100 each	**100,000**	100,000
Issued and fully paid: 640,195,313 shares of BD 0.100 each	**64,019**	56,906

Treasury stock

Treasury stock represents the purchase by the Bank of its own shares. At the end of the year, the Group held 5,478,374 shares (2005: 4,869,666) of its own shares, including 608,708 of bonus shares issued during 2006. Treasury stock does not carry the right to vote or to cash dividends.

15 RESERVES

Statutory reserve

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

General reserve

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

16 CUMULATIVE CHANGES IN FAIR VALUES

	2006 BD '000	2005 BD '000
Available-for-sale investments		
At 1 January	**28,940**	23,184
Realised on sale during the year	**(1,833)**	(1,699)
Movement in fair values during the year	**3,951**	7,455
At 31 December	**31,058**	28,940
Cash flow hedges		
At 1 January	**710**	(258)
Change in unrealised fair values during the year	**(133)**	769
Change in unrealised fair values - associated company (Note 8)	**23**	199
At 31 December	**600**	710
	31,658	29,650

17 PROPOSED APPROPRIATIONS

	2006 BD '000	2005 BD '000
Dividend	**25,389**	19,747
Directors' remuneration	**455**	390
Donations	**600**	600
Bonus shares	**3,201**	7,113
	29,645	27,850

The directors have proposed a cash dividend of 40% being BD 0.040 per share (2005: BD 0.035 per share), net of treasury stock. The directors have also proposed a bonus issue of one share for every twenty shares held.

The above appropriations will be submitted for formal approval at the Annual General Meeting to be held on 25 February 2007.

18 INTEREST INCOME

	2006 BD '000	2005 BD '000
Treasury bills	**2,203**	1,360
Deposits and due from banks and other financial institutions	**13,401**	7,997
Loans and advances to customers	**68,336**	50,387
Non trading investment securities	**20,559**	14,004
Notional interest on impaired financial assets	**875**	868
	105,374	74,616

19 INTEREST EXPENSE

	2006 BD '000	2005 BD '000
Deposits and due to banks and other financial institutions and borrowings under repurchase agreements	**15,687**	11,528
Medium term deposits from banks	**10,889**	3,577
Customers' current, savings and other deposits	**36,569**	23,801
	63,145	38,906

20 OTHER INCOME

	2006 BD '000	2005 BD '000
Fees and commission income	**15,577**	12,218
Fees and commission expense	**(2,294)**	(1,158)
	13,283	11,060
Dividend income	**2,204**	2,206
Realised gain on non-trading investments	**1,555**	1,699
Income from managed funds	**790**	897
Trading income	**368**	134
Gain on foreign exchange	**1,797**	1,648
Other	**1,168**	961
	7,882	7,545
	21,165	18,605

21 BASIC AND DILUTED EARNINGS PER SHARE

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

	2006	2005
Net profit for the year (BD '000)	**32,810**	29,328
Weighted average number of shares, net of treasury stock, outstanding during the year (*)	**634,716,938**	635,216,938
Basic earnings per share (BD)	**0.052**	0.046

Diluted earnings per share is same as basic earnings per share since the Group has not issued any dilutive potential financial instruments in 2005 and 2006.

(*) 2005 weighted average number adjusted for bonus shares issued in 2006.

22 SEGMENTAL INFORMATION

Business segments are distinguishable components of the Group that provide products or services subject to the risks and returns different from those of other business segments. Geographical segments are engaged in providing products or services within a particular economic environment subject to risks and return different from those of the segments operating in other economic environments.

Primary segment information

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

Retail banking	- Principally handling individual customers' deposits and providing consumer finance type loans, overdrafts, credit facilities and funds transfer facilities, card businesses and foreign exchange.
Corporate banking	- Principally handling loans and other credit facilities, deposit and current accounts for corporate and institutional customers in Bahrain.
International banking	- Principally handling loans and other credit facilities, deposit and current accounts for international corporate and institutional customers. This also covers the operations of the overseas units.
Investment, treasury and other activities	- Principally providing money market, trading and treasury services as well as the management of the Group's funding operations. Investment activities involve handling investments in local and international markets, investment advisory services and funds management. Other activities include business process outsourcing services.

22 SEGMENTAL INFORMATION continued

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

Segment information for the year ended 31 December 2006 was as follows:

	Retail banking BD '000	Corporate banking BD '000	International banking BD '000	Investment, treasury and other activities BD '000	Elimination BD '000	Total BD '000
External revenue	**23,608**	**26,526**	**44,520**	**31,885**	**-**	**126,539**
Inter-segmental revenue	**17,027**	**22,206**	**4,275**	**67,648**	**(111,156)**	**-**
Total revenue	**40,635**	**48,732**	**48,795**	**99,533**	**(111,156)**	**126,539**
Segment result	**10,263**	**6,571**	**6,573**	**8,366**		**31,773**
Income from associate and joint venture						**1,037**
Net profit for the year attributable to the shareholders of the parent						**32,810**
Segment assets	**184,007**	**333,080**	**697,462**	**450,490**		**1,665,039**
Investment in associated company and joint venture						**9,522**
Common assets						**19,205**
Total assets						**1,693,766**
Segment liabilities	**334,906**	**464,990**	**472,161**	**219,567**		**1,491,624**
Common liabilities						**14,184**
Total liabilities						**1,505,808**

Segment information for the year ended 31 December 2005 was as follows:

	Retail banking BD '000	Corporate banking BD '000	International banking BD '000	Investment, treasury and other activities BD '000	Elimination BD '000	Total BD '000
External revenue	21,081	18,757	31,039	22,344	-	93,221
Inter- segmental revenue	11,130	12,772	2,849	34,732	(61,483)	-
Total revenue	32,211	31,529	33,888	57,076	(61,483)	93,221
Segment result	8,973	6,609	6,329	5,846		27,757
Income from associate and joint venture						1,571
Net profit for the year attributable to the shareholders of the parent						29,328
Segment assets	168,796	308,846	578,048	416,911		1,472,601
Investment in associated company and joint venture						9,272
Common assets						16,904
Total assets						1,498,777
Segment liabilities	311,788	376,744	393,134	232,948		1,314,614
Common liabilities						10,770
Total liabilities						1,325,384

22 SEGMENTAL INFORMATION continued

Secondary segment information

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

Geographical areas:	Regional		International		Total	
	2006	2005	**2006**	2005	**2006**	2005
	BD '000	BD '000	**BD '000**	BD '000	**BD '000**	BD '000
Operating income before provisions	**42,428**	38,592	**20,966**	15,723	**63,394**	54,315
Total assets	**1,382,133**	1,206,307	**311,633**	292,470	**1,693,766**	1,498,777

23 CASH AND CASH EQUIVALENTS

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

	2006	2005
	BD '000	BD '000
Cash (Note-4)	**7,869**	7,885
Current account and placements with central banks (Note-4)	**24,717**	18,080
Treasury bills	**39,784**	23,806
Deposits and due from banks and other financial institutions with an original maturity within ninety one days	**163,049**	92,582
Cash and cash equivalents	**235,419**	142,353

24 RELATED PARTY TRANSACTIONS

Certain related parties (principally the major shareholders, associated companies, directors and key management of the Group, their families and entities controlled, jointly controlled or significantly influenced by such parties) were customers of the Group in the ordinary course of business. The transactions with these parties were made on substantially the same terms, including interest rates, as those prevailing at the same time for comparable transactions with unrelated parties and did not involve more than a normal amount of risk.

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

	Major shareholders BD '000	**Directors and key management BD '000**	**Associate and others BD '000**	**Total 2006 BD '000**	Total 2005 BD '000
Placements and loans and advances to customers	-	**674**	**5,744**	**6,418**	36,147
Non-trading investment securities	-	-	**4,856**	**4,856**	5,114
Borrowings and deposits from customers	**133,050**	**2,509**	**1,543**	**137,102**	152,872
Credit commitments	-	-	-	-	39

No provision is required in respect of loans given to related parties (2005: nil).

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

	Major shareholders BD '000	**Directors and key management BD '000**	**Associate and others BD '000**	**Total 2006 BD '000**	Total 2005 BD '000
Interest income on loans and advances to customers	-	**2**	**288**	**290**	1,223
Interest income on investment	-	-	**246**	**246**	115
Gain on non-trading investment securities	-	-	-	-	28
Interest expense on deposits	**6,650**	**90**	**3**	**6,743**	5,486

24 RELATED PARTY TRANSACTIONS continued

Compensation of the key management personnel (other than directors' remuneration which is shown under statement of changes in equity) is as follows:

	2006 BD '000	2005 BD '000
Short term employee benefits	**3,220**	2,453
Others	**573**	37
Total compensation paid to key management personnel	**3,793**	2,490

25 DERIVATIVES

A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instrument, reference rate or index. In the ordinary course of business, the Group enters into various types of transactions that involve derivative financial instruments. The use of derivatives is governed by the Group's policies approved by the Board of Directors. The Group enters into derivative contracts for the purpose of reducing risks from potential movements in foreign exchange rates and interest rates inherent in the Group's nontrading assets and liabilities.

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

				Notional amounts by term to maturity			
31 December 2006	**Positive fair value BD '000**	**Negative fair value BD '000**	**Notional amount Total BD '000**	**within 3 months BD '000**	**3 - 12 months BD '000**	**1 - 5 years BD '000**	**> 5 years BD '000**
Derivatives held for trading:							
Forward foreign exchange contracts	**63**	**52**	**14,046**	**2,514**	**11,532**	**-**	**-**
Options	**4**	**4**	**1,991**	**996**	**995**	**-**	**-**
Derivatives held as fair value hedges:							
Interest rate swaps	**559**	**-**	**28,537**	**-**	**-**	**23,461**	**5,076**
Forward foreign exchange contracts	**135**	**394**	**73,482**	**73,482**	**-**	**-**	**-**
Derivatives held as cash flow hedges:							
Interest rate swaps	**571**	**1**	**41,980**	**4,713**	**13,704**	**23,563**	**-**
	1,332	**451**	**160,036**	**81,705**	**26,231**	**47,024**	**5,076**

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

25 DERIVATIVES continued

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

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

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

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

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

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

26 COMMITMENTS AND CONTINGENT LIABILITIES

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

Commitments to extend credit represent unused portion of contractual commitments to make loans and revolving credits, principally in the form of loans and advances, guarantees and letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of loss, which can not readily be quantified, is expected to be considerably less than the total unused commitment as most of commitments to extend credit are contingent upon customer maintaining specific credit standards. Commitments generally have fixed expiration dates of less than one year or other termination clauses. Since commitments may expire without being drawn upon, the total contracted amounts do not necessarily represent future cash requirements.

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

26 COMMITMENTS AND CONTINGENT LIABILITIES continued

The Group has the following credit related commitments:

	2006 BD '000	2005 BD '000
Commitments on behalf of customers:		
Letters of credit	**99,341**	63,115
Guarantees	**176,643**	177,275
Acceptances	**10,470**	8,293
	286,454	248,683
Irrevocable commitments		
Undrawn loan commitments	**126,104**	47,397
Commitments in respect of investments	**1,084**	2,403
	127,188	49,800
	413,642	298,483

As at 31 December 2006, the Group also has capital commitments of BD 0.5 million (2005 BD 0.6 million).

	2006 BD '000	2005 BD '000
Irrecoverable commitments to extend credit:		
Original term to maturity of one year or less	**50,931**	27,157
Original term to maturity of more than one year	**76,257**	22,643
	127,188	49,800

27 CREDIT RISK AND CONCENTRATION OF CREDIT RISK

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

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

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

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

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

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

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

28 CONCENTRATION OF ASSETS, LIABILITIES AND OFF BALANCE SHEET ITEMS

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

	2006			2005		
	Assets BD '000	**Liabilities BD '000**	**Credit commitments BD '000**	Assets BD '000	Liabilities BD '000	Credit commitments BD '000
Geographical region:						
Gulf Co-operation Council countries	**1,382,133**	**1,144,436**	**288,420**	1,206,307	1,139,191	177,250
North America	**76,516**	**7,704**	**1,361**	75,438	11,831	2,522
European Union countries	**142,864**	**312,145**	**83,327**	129,078	152,995	81,345
Asia	**57,971**	**29,168**	**37,454**	66,869	18,817	33,598
Others	**34,282**	**12,355**	**3,080**	21,085	2,550	3,768
	1,693,766	**1,505,808**	**413,642**	1,498,777	1,325,384	298,483
Industry sector:						
Trading and manufacturing	**360,689**	**120,500**	**114,240**	316,280	66,230	88,021
Banks and other financial institutions	**567,834**	**552,066**	**227,416**	406,119	447,225	126,472
Construction and real estate	**169,200**	**30,639**	**41,925**	102,366	42,122	32,711
Government and public sector	**221,842**	**207,045**	**17,658**	305,981	235,273	8,470
Individuals	**193,379**	**340,202**	**1,313**	200,054	331,834	12,207
Others	**180,822**	**255,356**	**11,090**	167,977	202,700	30,602
	1,693,766	**1,505,808**	**413,642**	1,498,777	1,325,384	298,483
Month end average	**1,763,455**	**1,591,970**	**344,898**	1,575,241	1,413,627	258,397

29 MARKET RISK

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

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

The Group computes Value at Risk (VaR) for measuring general market risk in trading positions. VaR is a method used in measuring financial risk by estimating the potential negative change in the market value of a trading portfolio at a given confidence level and over a specified time horizon. The VaR model is approved by the Central Bank of Bahrain. The Group uses a full non-linear Var Model for interest rate, spread, equity index and volatility risk. The capital allocated for market risk is based on the VaR calculated at a 99 percent confidence level on a 10 day holding period.

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

30 INTEREST RATE RISK MANAGEMENT

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

The Board has established levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Positions are monitored on a regular basis and hedging strategies are used to ensure that the positions are maintained within the limits established by the Board. The Group uses primarily interest rate swaps to hedge against the interest rate risk arising from specifically identified fixed interest rate exposures. The Group also monitors the impact of a standardised rate shock on the economic value of equity.

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

As of 31 December 2006	Less than One month BD '000	One month to three months BD '000	Three months to six months BD '000	Six months to one year BD '000	One year to five years BD '000	Over five years BD '000	Not exposed to interest rate risk BD '000	Total BD '000
ASSETS								
Cash and balances with central banks	19,860	-	-	-	-	-	35,595	55,455
Treasury bills	16,534	23,250	-	-	-	-	-	39,784
Deposits and due from banks and other financial institutions	151,798	377	-	-	-	-	11,942	164,117
Loans and advances to customers	337,294	272,679	99,497	40,177	58,031	107,102	23,262	938,042
Non-trading investment securities	86,071	22,448	85,095	53,062	107,494	42,206	49,247	445,623
Investment in associated company and joint venture	-	-	-	-	-	-	9,522	9,522
Interest receivable and other assets	-	-	-	-	-	-	22,335	22,335
Premises and equipment	-	-	-	-	-	-	18,888	18,888
Total assets	611,557	318,754	184,592	93,239	165,525	149,308	170,791	1,693,766
LIABILITIES AND EQUITY								
Deposits and due to banks and other financial institutions	241,576	8,831	48	9,172	-	-	4,131	263,758
Borrowings under repurchase agreements	855	15,563	-	-	-	-	-	16,418
Medium term deposits from banks	18,850	216,775	-	-	-	-	-	235,625
Customers' current, savings and other deposits	543,631	141,981	91,403	29,658	2,712	-	154,499	963,884
Interest payable and other liabilities	-	-	-	-	-	-	26,123	26,123
Equity	-	-	-	-	-	-	187,958	187,958
Total liabilities and equity	804,912	383,150	91,451	38,830	2,712	-	372,711	1,693,766
On-balance sheet gap	(193,355)	(64,396)	93,141	54,409	162,813	149,308	(201,920)	
Off-balance sheet gap	16,645	11,768	12,245	11,442	(47,024)	(5,076)		
Total interest rate sensitivity gap	(176,710)	(52,628)	105,386	65,851	115,789	144,232	(201,920)	
Cumulative interest rate sensitivity gap	(176,710)	(229,338)	(123,952)	(58,101)	57,688	201,920	-	

30 INTEREST RATE RISK MANAGEMENT continued

As of 31 December 2005	Less than One month BD '000	One month to three months BD '000	Three months to six months BD '000	Six months to one year BD '000	One year to five years BD '000	Over five years BD '000	Not exposed to interest rate risk BD '000	Total BD '000
ASSETS								
Cash and balances with central banks	9,038	-	-	-	-	-	40,648	49,686
Treasury bills	9,961	13,845	-	-	-	-	-	23,806
Trading investments	10	-	-	-	-	-	-	10
Deposits and due from banks and other financial institutions	78,335	32,421	17,400	-	-	-	2,557	130,713
Loans and advances to customers	312,528	187,036	141,320	14,183	32,952	87,732	19,255	795,006
Non-trading investment securities	10,493	168,077	95,270	80,054	11,123	39,666	52,793	457,476
Investment in associated company and joint venture	-	-	-	-	-	-	9,272	9,272
Interest receivable and other assets	-	-	-	-	-	-	16,009	16,009
Premises and equipment	-	-	-	-	-	-	16,799	16,799
Total assets	420,365	401,379	253,990	94,237	44,075	127,398	157,333	1,498,777
LIABILITIES AND EQUITY								
Deposits and due to banks and other financial institutions	201,713	29,276	4,610	137	-	-	2,506	238,242
Borrowings under repurchase agreements	1,753	100,250	-	-	-	-	-	102,003
Medium term deposits from banks	18,850	75,400	-	-	-	-	-	94,250
Customers' current, savings and other deposits	511,729	140,228	37,939	41,393	3,106	-	129,005	863,400
Interest payable and other liabilities	-	-	-	-	-	-	27,489	27,489
Equity	-	-	-	-	-	-	173,393	173,393
Total liabilities and equity	734,045	345,154	42,549	41,530	3,106	-	332,393	1,498,777
On-balance sheet gap	(313,680)	56,225	211,441	52,707	40,969	127,398	(175,060)	
Off-balance sheet gap	32,987	23,054	12,245	(22,620)	(9,859)	(35,807)	-	
Total interest rate sensitivity gap	(280,693)	79,279	223,686	30,087	31,110	91,591	(175,060)	
Cumulative interest rate sensitivity gap	(280,693)	(201,414)	22,272	52,359	83,469	175,060	-	

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

30 INTEREST RATE RISK MANAGEMENT continued

	31 December 2006 Effective interest rate %			31 December 2005 Effective interest rate %		
	BD	**KD**	**US$**	BD	KD	US$
Assets						
Treasury bills	**4.9**	**-**	**-**	3.3	-	-
Deposits and due from banks and financial institutions	**4.9**	**5.5**	**5.1**	3.5	3.2	3.3
Loans and advances to customers (*)	**8.4**	**6.3**	**6.0**	7.4	7.5	4.4
Non-trading investment securities	**3.7**	**5.8**	**6.0**	4.1	4.0	4.4
Liabilities						
Deposits and due to banks and other financial institutions	**4.0**	**5.3**	**5.2**	3.2	3.0	3.4
Medium term deposits from banks	**-**	**-**	**5.8**	-	-	3.7
Customers' current, savings and other deposits (**)	**3.1**	**4.8**	**5.1**	1.9	3.0	3.1

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

(**) The effective interest rates have been computed by excluding non-interest bearing accounts.

31 CURRENCY RISK

The functional currency of the Group is the Bahraini Dinar.

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

	2006 BD '000 equivalent long (short)	2005 BD '000 equivalent long (short)
US dollars	**92,943**	75,167
Euro	**11**	175
G.C.C. currencies	**(38)**	2,022
Others	**300**	592

As the Bahraini Dinar is pegged to the US Dollar, positions in US Dollars are not considered to represent significant currency risk.

The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on a daily basis to ensure that they are maintained within established limits. The Group uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks.

32 EQUITY PRICE RISK

Equity price risk is risk that the fair value of equities or equity funds decreases as a result of changes in the corresponding value of equity indices or the value of individual equity stocks. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

33 LIQUIDITY RISK

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

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

As of 31 December 2006	Less than 1 month BD '000	1 month to 3 months BD '000	3 months to 6 months BD '000	6 months to 1 year BD '000	1-5 years BD '000	5-10 years BD '000	10-20 years BD '000	More than 20 years BD '000	Undated BD '000	Total BD '000
ASSETS										
Cash and balances with central banks	32,737	180	217	392	384	-	-	-	21,545	55,455
Treasury bills	16,534	23,250	-	-	-	-	-	-	-	39,784
Deposits and due from banks and other financial institutions	163,740	377	-	-	-	-	-	-	-	164,117
Loans and advances to customers	48,676	98,513	100,623	108,693	276,627	245,114	58,315	1,481	-	938,042
Non-trading investment securities	1,045	1,964	78,298	55,701	161,172	100,661	-	-	46,782	445,623
Investment in associated company and joint venture	-	-	-	-	-	-	-	-	9,522	9,522
Interest receivable and other assets	20,935	49	75	-	901	3	-	-	372	22,335
Premises and equipment	-	-	-	-	-	-	-	-	18,888	18,888
Total assets	283,667	124,333	179,213	164,786	439,084	345,778	58,315	1,481	97,109	1,693,766
LIABILITIES										
Deposits and due to banks and other financial institutions	245,707	8,831	48	9,172	-	-	-	-	-	263,758
Borrowings under repurchase agreements	855	15,563	-	-	-	-	-	-	-	16,418
Medium term deposits from banks	-	-	-	-	235,625	-	-	-	-	235,625
Customers' current, savings and other deposits	702,150	132,263	91,106	29,984	8,381	-	-	-	-	963,884
Interest payable and other liabilities	25,631	142	122	106	81	41	-	-	-	26,123
Total liabilities	974,343	156,799	91,276	39,262	244,087	41	-	-	-	1,505,808
Net liquidity gap	(690,676)	(32,466)	87,937	125,524	194,997	345,737	58,315	1,481	97,109	187,958

33 LIQUIDITY RISK continued

As of 31 December 2005	Less than 1 month BD '000	1 month to 3 months BD '000	3 months to 6 months BD '000	6 months to 1 year BD '000	1-5 years BD '000	5-10 years BD '000	10-20 years BD '000	More than 20 years BD '000	Undated BD '000	Total BD '000
ASSETS										
Cash and balances with central banks	25,924	41	407	274	1,057	8	-	-	21,975	49,686
Treasury bills	9,961	13,845	-	-	-	-	-	-	-	23,806
Trading investments	10	-	-	-	-	-	-	-	-	10
Deposits and due from banks and other financial institutions	80,893	32,421	17,399	-	-	-	-	-	-	130,713
Loans and advances to customers	41,666	87,148	84,409	91,987	242,076	211,222	36,498	-	-	795,006
Non-trading investment securities	-	36,655	51,577	72,896	145,433	107,453	-	-	43,462	457,476
Investment in associated company and joint venture	-	-	-	-	-	-	-	-	9,272	9,272
Interest receivable and other assets	11,549	1,694	101	13	2,247	335	70	-	-	16,009
Premises and equipment	-	-	-	-	-	-	-	-	16,799	16,799
Total assets	170,003	171,804	153,893	165,170	390,813	319,018	36,568	-	91,508	1,498,777
LIABILITIES										
Deposits and due to banks and other financial institutions	204,219	29,276	4,610	137	-	-	-	-	-	238,242
Borrowings under repurchase agreements	1,753	100,250	-	-	-	-	-	-	-	102,003
Medium term deposits from banks	-	-	-	47,125	47,125	-	-	-	-	94,250
Customers' current, savings and other deposits	637,437	138,963	32,273	37,850	16,857	20	-	-	-	863,400
Interest payable and other liabilities	27,006	104	60	60	147	112	-	-	-	27,489
Total liabilities	870,415	268,593	36,943	85,172	64,129	132	-	-	-	1,325,384
Net liquidity gap	(700,412)	(96,789)	116,950	79,998	326,684	318,886	36,568	-	91,508	173,393

34 FUNDS UNDER MANAGEMENT

Funds under management at the year-end amounted to BD 46.1 million (31 December 2005 BD 53.6 million). These assets are held in a fiduciary capacity and are not included in the consolidated balance sheet.

35 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

	31 December 2006			31 December 2005		
	Carrying value BD '000	**Fair value BD '000**	**Difference BD '000**	Carrying value BD '000	Fair value BD '000	Difference BD '000
Financial assets						
Non-trading investment securities	**243,238**	**250,223**	**6,985**	245,028	248,752	3,724

As explained in note 7, included under non-trading investments are unquoted investments amounting to BD 42.1 million (2005: BD 41.1 million) for which fair value cannot be reliably determined.

36 CAPITAL ADEQUACY

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

	2006 BD '000	2005 BD '000
Capital base:		
Tier 1 capital	**123,933**	115,155
Tier 2 capital	**66,359**	60,586
Total capital base (a)	**190,292**	175,741
Credit risk weighted exposure:		
On-balance sheet	**988,810**	813,934
Off-balance sheet	**176,954**	76,519
Total	**1,165,764**	890,453
Market risk weighted exposure:		
On-balance sheet	**-**	-
Off-balance sheet	**8,855**	7,683
Total	**8,855**	7,683
Total risk weighted exposure (b)	**1,174,619**	898,136
Capital adequacy (a/b * 100)	**16.20%**	19.57%
Minimum requirement	**12%**	12%

37 LEGAL RISK AND CLAIMS

Legal risk is the risk relating to losses due to legal or regulatory action that invalidates or otherwise precludes performance by the end user or its counterparty under the terms of the contract or related netting agreements.

The Group has developed preventive controls and formalised procedures to identify legal risks so that potential losses arising from non-adherence to laws and regulations, negative publicity, etc. are significantly reduced. The Group also has well established legal procedures to scrutinise product offerings and manage risks arising out of its transactions.

As at 31 December 2006, there were legal suits pending against the Group aggregating BD 1.7 million (2005 BD 1.9 million). Based on the opinion of the Group's legal advisors, the management believes that no liability is likely to arise from these suits.

38 DEPOSIT PROTECTION SCHEME

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