

Ahli United Bank B.S.C.

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2003

Board of Directors' Report

The Directors of Ahli United Bank ("AUB" or the "Bank") are pleased to submit the Annual Report and accompanying consolidated Financial Statements for the year ended 31 December 2003.

The highlights of the year were the continued solid increase in revenues and assets, the substantial reduction of the cost-to-income ratio and the successful progress in implementing an integrated technology platform across the Group.

Net profit of US\$ 87.1 million represented a 46% increase over the comparable figure for 2002 of \$59.7 million. At the year end, total assets stood at US\$ 6.2 billion (2002 – US\$ 5.1 billion) and shareholders' equity amounted to US\$ 936.1 million (2002 – US\$ 830.6 million). Total operating income increased to US\$ 195.4 million from US\$ 163 million in 2002, despite downward pressure on interest rates, while total deposits amounted to US\$ 4.5 billion, a 20% increase on 2002. In summary, during a period of continued internal consolidation as well as difficult market conditions in most major economies, 2003 was a year of solid achievement and continued positive growth. The Bank's cost-to-income ratio improved to 39.4% from 44.2% in 2002. Operating costs of US\$ 76.9 million increased by US\$ 4.9 million or 6.8% primarily due to the appreciation of sterling based expenses upon translation. The Bank's consolidated risk asset ratio of 21% comfortably exceeded regulatory levels. These excellent results have built on those of last year and enabled AUB to pay a higher dividend of 2.4 cents per share (2002 – 2.3 cents) despite the significant increase in its outstanding shares from 1,800 million to 2,600 million shares on 29 December 2002.

The strong financial performance was the product of the clear and continuing strategic direction provided by the Board of Directors and effectively implemented by a strong, dedicated management team. It is the Bank's stated intention to expand through organic growth and by acquisitions in order to act as a "multifaceted financial bridge" between the international financial markets and its Gulf clients. The Bank is well placed to offer a comprehensive range of services to a wider customer base in the Gulf and beyond by leveraging on the access and capabilities provided by AUBUK, its London based subsidiary and by its expanding regional presences.

Functionally, the year was dominated by the launch of various new consumer products and structured deposits, by the effective use of the capital raised through the share issue of December 2002, and by the implementation of the integrated AUB Group technology platform.

Directors held 96,731,625 shares as at 31 December 2003 (2002 – 81,960,376 shares). Directors' fees, allowances, expenses, salaries and remuneration totaled US\$ 1,103,000 (2002 – US\$ 976,000). Executive management held 256,182 shares as at 31 December 2003 (unchanged from prior year).

On the basis of the results of the Bank for the year ended 31 December 2003, the Board of Directors recommends the following appropriation of the Bank's net profit for approval by the shareholders:

	US\$ '000
Proposed dividend	62,400
Proposed directors' fees	346
Transfer to statutory reserve	8,708
Transfer to retained earnings	15,622
Profit available for allocation	87,076

In conclusion, we would like to thank all our regulators, shareholders, clients, business partners and staff for their joint contribution to AUB's success in 2003.

Fahad Al-Rajaan
Chairman
9 February 2004

AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI UNITED BANK B.S.C.

We have audited the accompanying consolidated balance sheet of Ahli United Bank B.S.C. (the Bank) and its subsidiaries (the Group) as of 31 December 2003, and the related consolidated statements of income, cash flows and changes in equity for the year then ended. These consolidated financial statements are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2003 and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements, and the contents of the Report of the Board of Directors relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Bahrain Monetary Agency Law, nor of the memorandum and articles of association of the Bank have occurred during the year ended 31 December 2003 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position, and that the Bank has complied with the terms of its banking licence. We obtained all the information and explanations which we required for the purpose of our audit.



9 February 2004
Manama, Kingdom of Bahrain


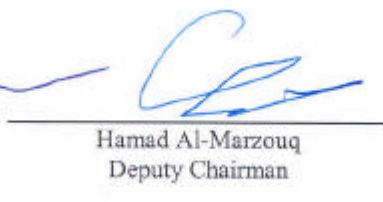
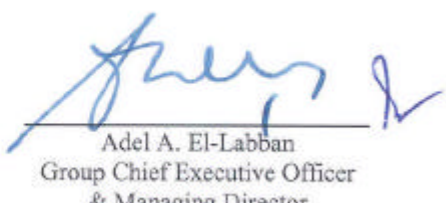
Ahli United Bank B.S.C.

CONSOLIDATED BALANCE SHEET

31 December 2003

	<i>Note</i>	<i>2003</i> <i>US\$ '000</i>	<i>2002</i> <i>US\$ '000</i>
ASSETS			
Cash and balances with central banks	4	60,304	52,350
Trading securities		19,553	10,831
Deposits with banks and other financial institutions		1,259,684	883,537
Loans and advances	5	2,506,945	2,168,275
Non-trading investments	6	1,721,373	1,430,483
Investment in associates	2	501,527	438,205
Premises and equipment		54,958	47,323
Other assets and intangibles	7	145,722	104,892
		-----	-----
		6,270,066	5,135,896
		-----	-----
LIABILITIES, SUBORDINATED LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks and other financial institutions		1,674,068	1,395,614
Customers' deposits		2,807,183	2,348,983
Certificates of deposits	8	111,949	75,293
Floating rate notes and other term debt	8	414,242	233,083
Other liabilities	9	197,013	128,985
		-----	-----
		5,204,455	4,181,958
		-----	-----
SUBORDINATED LIABILITIES	10	129,466	123,323
		-----	-----
EQUITY			
Share capital	11	650,000	650,000
Reserves	12	286,145	180,615
		-----	-----
		936,145	830,615
		-----	-----
		6,270,066	5,135,896
		-----	-----

These consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 9 February 2004.

 Fahad Al-Rajaan Chairman	 Hamad Al-Marzouq Deputy Chairman	 Adel A. El-Labban Group Chief Executive Officer & Managing Director
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The attached notes 1 to 31 form part of these consolidated financial statements.

Ahli United Bank B.S.C.

CONSOLIDATED STATEMENT OF INCOME

Year ended 31 December 2003

	<i>Note</i>	<i>2003</i> <i>US\$ '000</i>	<i>2002</i> <i>US\$ '000</i>
OPERATING INCOME			
Interest income		220,006	211,672
Interest expense		108,063	115,408
		-----	-----
Net interest income		111,943	96,264
		-----	-----
Fees and commission - net	13	33,508	33,849
Trading income	14	4,104	3,786
Gains on sale of non-trading investments		9,842	8,389
Share of profit from associates		22,899	9,779
Other operating income		13,123	10,965
		-----	-----
		83,476	66,768
		-----	-----
NET INTEREST AND OTHER INCOME		195,419	163,032
		-----	-----
Provision for loan losses - net	5	16,185	19,419
Provision for impairment of non-trading investments	6	8,023	4,679
		-----	-----
		24,208	24,098
		-----	-----
OPERATING INCOME AFTER PROVISIONS		171,211	138,934
		-----	-----
OPERATING EXPENSES			
Staff expenses		44,193	39,433
Depreciation and amortisation		6,030	6,423
Other operating expenses		26,681	26,145
		-----	-----
		76,904	72,001
		-----	-----
PROFIT BEFORE TAXATION		94,307	66,933
Taxation	15	7,231	7,207
		-----	-----
NET PROFIT FOR THE YEAR		87,076	59,726
		-----	-----
Basic earnings per share (cents)	16	3.35	3.30
		-----	-----
Weighted average number of shares outstanding (in millions)		2,600	1,807
		-----	-----

The attached notes 1 to 31 form part of these consolidated financial statements.

Ahli United Bank B.S.C.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2003

	2003 US\$ '000	2002 US\$ '000
OPERATING ACTIVITIES		
Profit before taxation	94,307	66,933
Adjustments for:		
Depreciation and amortisation	6,030	6,423
Gains on sale of non-trading investments	(9,842)	(8,389)
Provision for loan losses - net	16,185	19,419
Provision for impairment of non-trading investments	8,023	4,679
Share of profit from associates	(22,899)	(9,779)
	-----	-----
Operating profit before changes in operating assets and liabilities	91,804	79,286
Changes in:		
Mandatory reserve deposits with central banks	(2,946)	(2,292)
Trading securities	(8,722)	(10,476)
Deposits with banks and other financial institutions	19,727	(26,739)
Loans and advances	(354,855)	(304,995)
Other assets and intangibles	(41,594)	(33,259)
Due to banks and other financial institutions	278,454	656,714
Customers' deposits	458,200	(17,103)
Certificates of deposits	36,656	35,088
Other liabilities	69,484	43,502
	-----	-----
Cash from operations	546,208	419,726
Tax paid	(9,005)	(9,348)
	-----	-----
Net cash from operating activities	537,203	410,378
	-----	-----
INVESTING ACTIVITIES		
Purchase of non-trading investments	(742,119)	(711,439)
Proceeds from sale of non-trading investments	493,275	208,571
Investment in associates	(24,613)	(260,762)
Purchase of premises and equipment	(13,577)	(9,224)
Sale of premises and equipment	676	-
	-----	-----
Net cash (used in) investing activities	(286,358)	(772,854)
	-----	-----
FINANCING ACTIVITIES		
Proceeds from issue of share capital	-	242,971
Increase in subordinated liabilities	6,143	35,088
Floating rate notes and other term debt	181,159	13,365
Dividends	(41,553)	(41,400)
	-----	-----
Net cash from financing activities	145,749	250,024
	-----	-----
Foreign currency translation adjustments	4,288	13,870
	-----	-----
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	400,882	(98,582)
Cash and cash equivalents at 1 January	824,538	923,120
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CASH AND CASH EQUIVALENTS AT 31 DECEMBER (Note 17)	1,225,420	824,538
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The attached notes 1 to 31 form part of these consolidated financial statements.

Ahli United Bank B.S.C.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

31 December 2003

	<i>Share capital</i> US\$ '000	<i>Share premium</i> US\$ '000	<i>Capital reserve</i> US\$ '000	<i>Statutory reserve</i> US\$ '000	<i>Foreign currency translation adjustments</i> US\$ '000	<i>Retained earnings</i> US\$ '000	<i>Proposed appropriations</i> US\$ '000	<i>Cumulative changes in fair values</i> US\$'000	<i>Total</i> US\$ '000
Balance at 31 December 2001	450,000	80,781	307	8,849	(25,384)	2,786	41,610	5,353	564,302
Dividends and other appropriations paid	-	-	-	-	-	-	(41,610)	-	(41,610)
Issuance of ordinary shares	200,000	42,971	-	-	-	-	-	-	242,971
Net profit for the year – 2002	-	-	-	-	-	59,726	-	-	59,726
Currency translation adjustments	-	-	-	-	13,870	-	-	-	13,870
Net gain on sale of available-for-sale investments (previously included in retained earnings on adoption of IAS 39)	-	-	-	-	-	(810)	-	-	(810)
Net fair value movements during the year	-	-	-	-	-	-	-	(7,834)	(7,834)
Transfer to statutory reserve	-	-	-	5,973	-	(5,973)	-	-	-
Proposed dividends	-	-	-	-	-	(41,553)	41,553	-	-
Proposed directors' remuneration	-	-	-	-	-	(318)	318	-	-
Balance at 31 December 2002	650,000	123,752	307	14,822	(11,514)	13,858	41,871	(2,481)	830,615
Dividends and other appropriations paid	-	-	-	-	-	-	(41,871)	-	(41,871)
Net profit for the year – 2003	-	-	-	-	-	87,076	-	-	87,076
Currency translation adjustments	-	-	-	-	4,288	-	-	-	4,288
Net gain on sale of available-for-sale investments (previously included in retained earnings on adoption of IAS 39)	-	-	-	-	-	(968)	-	-	(968)
Net fair value movements during the year	-	-	-	-	-	-	-	57,005	57,005
Transfer to statutory reserve	-	-	-	8,708	-	(8,708)	-	-	-
Proposed dividends	-	-	-	-	-	(62,400)	62,400	-	-
Proposed directors' remuneration	-	-	-	-	-	(346)	346	-	-
Balance at 31 December 2003	650,000	123,752	307	23,530	(7,226)	28,512	62,746	54,524	936,145

The attached notes 1 to 31 form part of these consolidated financial statements.

1 ACTIVITIES

The parent company, Ahli United Bank B.S.C. (the 'Bank') was incorporated in the Kingdom of Bahrain on 31 May 2000 originally as a closed company and changed on 12 July 2000 to a public shareholding company by Amiri Decree no. 16/2000, and is engaged in commercial and investment banking business, global fund management and private banking services directly and through its subsidiaries. The Bank operates under an offshore banking unit licence issued by the Bahrain Monetary Agency. The registered office of Ahli United Bank B.S.C. is located at 120 Government Avenue, P O Box 2424, Manama, Kingdom of Bahrain.

The number of staff employed by the Group as of 31 December 2003 was 568 (31 December 2002: 534).

2 CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements comprise the financial statements of Ahli United Bank B.S.C. and its principal subsidiaries (together known as "the Group"). The operating results of principal associates are equity accounted in the consolidated financial statements including the broad concepts underlying the consolidation procedures. The following are the principal subsidiaries and associates:

<u>Name</u>	<u>Country of incorporation</u>	<u>Percentage holding</u>
<i>a) Principal subsidiaries</i>		
Ahli United Bank (Bahrain) B.S.C. (c)	Kingdom of Bahrain	100%
Ahli United Bank (U.K.) PLC	United Kingdom	100%
<i>b) Principal associate</i>		
Bank of Kuwait and Middle East K.S.C.	State of Kuwait	47%

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

3 SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

The consolidated financial statements of Ahli United Bank B.S.C. are prepared in conformity with the Bahrain Commercial Companies Law and the Bahrain Monetary Agency Law and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB.

The significant accounting policies adopted, which are consistent with those used in the previous year, are as follows:

Accounting convention

The consolidated financial statements are prepared under the historical cost convention as modified for the measurement at fair value of derivatives, trading securities and non-trading investments. In addition, as more fully discussed below, assets and liabilities that are hedged are adjusted to the extent of the fair value of the risk being hedged.

The financial statements are presented in US dollars being the currency in which the share capital of the Bank is denominated.

Trading securities

Trading securities are initially recognised at cost and subsequently remeasured at fair value with any gains or losses arising from a change in fair value being included in the consolidated statement of income in the period in which it arises.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Deposits with banks and other financial institutions

Deposits with banks and other financial institutions are stated net of amounts written off and provision for impairment.

Loans and advances

Loans and advances are stated at cost, adjusted for effective fair value hedges, less any amounts written off and provision for impairment.

Non-trading investments

These are classified as either held-to-maturity, available-for-sale or originated by the Group. All investments are initially recognised at cost, being the fair value of the consideration given, including acquisition costs associated with the investment. Premiums and discounts are amortised on a systematic basis to maturity using the effective interest method and taken to interest income.

Available-for-sale

After initial recognition, available-for-sale investments are remeasured at fair value. Unless unrealised gains and losses on remeasurement to fair value are part of an effective hedging relationship, they are reported as a separate component of equity until the investment is sold, collected or otherwise disposed of, or the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the consolidated statement of income for the period.

Any gain or loss arising from a change in fair value of available-for-sale investments, which are part of an effective hedging relationship, is recognised directly in the consolidated statement of income to the extent of the changes in fair value being hedged.

Originated by the Group

Investments in debt securities, which are funded directly to the issuer, are stated at amortised cost, adjusted for effective fair value hedges, less provision for impairment.

Held-to-maturity

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

Where investments are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and the consideration received is classified as "Due to banks and other financial institutions" or "Floating rate notes and other term debt" as appropriate. Conversely, securities purchased under similar commitments to resell are not recognised on the balance sheet and the consideration paid is recorded in "Deposits with banks and other financial institutions".

Fair values

For investments actively traded in organised financial markets, fair value is determined by reference to quoted market bid prices at the close of business on the balance sheet date.

The fair value of interest-bearing financial assets and liabilities is estimated based on discounted cash flows using current market rates for financial instruments with similar terms and risk characteristics.

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

The fair value of over-the-counter options is determined by using option-pricing models.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Investment in associates

Associated companies are companies in which the Group has a long-term interest of between 20% and 50% in the voting capital or over which it exerts significant influence. Investments in associated companies are accounted for using the equity method.

Goodwill

Goodwill, representing the excess of the cost of an acquisition over the fair value of the Group's share of identifiable net assets of a subsidiary or an associate at the date of acquisition, is amortised using the straight-line method over its estimated useful life of 40 years. At each balance sheet date, goodwill is reviewed for impairment.

Premises and equipment

Premises and equipment is stated at cost, less accumulated depreciation.

The cost of freehold land is not depreciated. Depreciation on other premises and equipment is provided on a straight-line basis over their estimated useful lives.

The estimated useful lives of the assets for the calculation of depreciation are as follows:

Freehold buildings	15 to 20 years
Leasehold buildings	Over the period of lease
Other premises and equipment	2 to 6 years

Collateral pending sale

The Group occasionally acquires real estate in settlement of loans and advances. Such real estate is stated at the lower of the net realisable value of the related loans and advances at the time of acquisition and the current fair value of such assets. Gains and losses on disposal, and unrealised losses on revaluation, are recognised in the consolidated statement of income.

Deposits

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

Liabilities

Liabilities that are held for trading are subsequently remeasured at fair value and any gain or loss arising from a change in fair value is included in the consolidated statement of income in the period in which it arises.

Taxation

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

Deferred taxation is provided using the liability method on all temporary differences calculated at the rate at which it is expected to be payable. Deferred tax assets are only recognised if recovery is probable.

Employee benefits

Pension scheme

Pension costs are recognised on a systematic basis so that the costs of providing retirement benefits to employees are evenly matched, so far as possible, to the service lives of the employees concerned. Any excess or deficiency of the actuarial value of assets over the actuarial value of liabilities of the pension scheme is allocated over the average remaining service lives of the scheme members.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Defined contribution plans

The Bahraini employees of the parent and its subsidiary Ahli United Bank (Bahrain) BSC (c) are covered under the General Organisation of Social Insurance Scheme (GOSI) and the Group's obligations are limited to the amounts contributed to the Scheme. Ahli United Bank (UK) PLC also operates a defined contribution plan, the costs of which are recognized in the period to which they relate.

Other defined benefit plan

In accordance with the Bahrain Labour law the parent and its subsidiary Ahli United Bank (Bahrain) B.S.C. (c) provide for end of service benefits for its non-Bahraini employees. The provision is based on accumulated periods of service and estimated salary at the time of leaving.

Provisions

Provisions are recognised when the Group has a present obligation arising from a past event, and costs to settle the obligation are both probable and able to be reliably estimated.

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. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative at prevailing market rates. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the consolidated balance sheet.

For the purposes of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (b) cash flow hedges which hedge exposure to variability in cash flows that is 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 statement of income. The hedged item is adjusted for fair value changes relating to the risk being hedged and the difference is recognised in the consolidated statement of income.

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

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. In the case of fair value hedges of interest-bearing financial instruments any adjustment relating to the hedged item is amortised over the remaining term to maturity. In the case of cash flow hedges, the cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the forecasted transaction occurs, unless the hedged transaction is no longer expected to occur, in which case the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of income for the period.

Fiduciary assets

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

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

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 is recognised on a time proportion basis, taking account of the principal outstanding and the rate applicable. Loan interest that is 90 days or more overdue is excluded from income. Notional interest is recognised on impaired loans and advances and other financial assets based on the rate used to discount future cash flows to their net present values.

Fees and commission income are recognised when earned. Dividend income is recognised when the right to receive payment is established.

Foreign currencies

Monetary assets and liabilities in foreign currencies are re-translated into US dollars at the rates of exchange prevailing at the balance sheet date. Any gains and losses are taken to the consolidated statement of income.

The assets and liabilities of foreign entities are translated into US dollars at the rates of exchange prevailing at the balance sheet date. Income and expense items are translated at average exchange rates prevailing for the period. Any exchange differences are taken directly to a "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 reserves, plus those deposits with banks and other financial institutions and treasury bills which mature within three months from the balance sheet date.

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, the estimated recoverable amount of that asset is determined and any impairment loss, based on the net present value of future anticipated cash flows, is recognised in the consolidated statement of income.

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

Settlement date accounting

All "regular way" purchases and sales of financial assets are recognised on the settlement date, i.e. the date that the Group receives or delivers 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2003

4 CASH AND BALANCES WITH CENTRAL BANKS

	<i>2003</i>	<i>2002</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Cash and balances with central banks, excluding mandatory reserve deposits	26,458	21,450
Mandatory reserve deposits with central banks	33,846	30,900
	60,304	52,350

Mandatory reserve deposits are not available for use in the day-to-day operations.

5 LOANS AND ADVANCES

The composition of the loans and advances portfolio, net of provisions, is as follows:

Industry sector	<i>2003</i>				<i>2002</i>	
	<i>Bahrain</i>	<i>Foreign</i>	<i>Total</i>	<i>%</i>	<i>Total</i>	<i>%</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>		<i>US\$ '000</i>	
Consumer finance	472,668	591,325	1,063,993	40.1	898,915	39.0
Real estate	66,693	403,985	470,678	17.7	504,711	21.9
Trading and manufacturing	151,463	491,026	642,489	24.2	480,038	20.9
Banks and other financial institutions	46,251	57,307	103,558	3.9	114,657	5.0
Government/public sector	5,278	-	5,278	0.2	1,682	0.1
Others	47,950	317,759	365,709	13.9	301,755	13.1
	790,303	1,861,402	2,651,705	100.0	2,301,758	100.0
Less: Provisions	(106,690)	(38,070)	(144,760)	(5.5)	(133,483)	(5.8)
	683,613	1,823,332	2,506,945	94.5	2,168,275	94.2
Geographic region						
G.C.C. countries			987,285	37.2	918,691	39.9
United Kingdom			897,861	33.9	831,878	36.1
Europe			391,602	14.8	251,035	10.9
United States of America			96,252	3.6	90,965	4.0
Asia			70,697	2.7	49,903	2.2
Others			208,008	7.8	159,286	6.9
			2,651,705	100.0	2,301,758	100.0
Less: Provisions			(144,760)	(5.5)	(133,483)	(5.8)
			2,506,945	94.5	2,168,275	94.2

5 LOANS AND ADVANCES (continued)

Age analysis of non-performing loans on which interest is not being accrued:

	2003				2002
	<i>3 months</i>		<i>Over</i>		
	<i>to 1 year</i>	<i>1 - 3 years</i>	<i>3 years</i>	<i>Total</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Gross non-performing loans	10,130	86,860	64,242	161,232	172,464
Less: Provisions				(124,142)	(112,397)
Less: Interest in suspense				(20,618)	(21,086)
				-----	-----
Net outstanding				16,472	38,981
				-----	-----

During the year ended 31 December 2003, the Group restructured credit facilities amounting to US\$18 million (2002 : US\$10 million). The restructured facilities have no material impact on the current year's earnings and are expected to have no material adverse effect on future earnings.

The movements in provisions during the year were as follows:

	2003	2002
	<i>US\$ '000</i>	<i>US\$ '000</i>
At 1 January	133,483	114,947
Arising from acquisition of a subsidiary	-	11,495
Amounts written off during the year	(10,386)	(18,096)
Charge for the year	23,247	22,958
Recoveries	(7,062)	(3,539)
Interest suspended during the year	4,625	4,883
Exchange rate adjustments/ other	853	835
	-----	-----
At 31 December	144,760	133,483
	-----	-----

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2003

6 NON-TRADING INVESTMENTS

31 December 2003	2003			2002	
	Available- for-sale US\$'000	Held-to- maturity US\$'000	Originated by the Group US\$'000	Total US\$'000	Total US\$'000
Quoted investments					
Bahrain government bonds and debt securities	73,658	-	-	73,658	12,812
Other government bonds and debt securities	204,646	-	19,846	224,492	179,227
Floating rate notes and certificates of deposits:					
- issued by banks and other financial institutions	592,922	-	55,884	648,806	444,349
- issued by corporate bodies	611,944	7,818	4,749	624,511	590,275
Equity shares	13,892	-	-	13,892	47,498
Other investments	-	-	-	-	7,202
	-----	-----	-----	-----	-----
	1,497,062	7,818	80,479	1,585,359	1,281,363
	-----	-----	-----	-----	-----
Unquoted investments					
Bahrain government bonds and debt securities	6,682	-	-	6,682	22,480
Other government bonds and debt securities	17,969	-	15,000	32,969	34,774
Floating rate notes and certificates of deposits:					
- issued by banks and other financial institutions	-	-	31,562	31,562	64,894
- issued by corporate bodies	54,825	-	4,749	59,574	3,346
Equity shares at cost	11,755	-	-	11,755	9,312
Other investments	13,919	-	-	13,919	26,106
	-----	-----	-----	-----	-----
	105,150	-	51,311	156,461	160,912
	-----	-----	-----	-----	-----
Total	1,602,212	7,818	131,790	1,741,820	1,442,275
Less : Provision for impairment	(19,292)	-	(1,155)	(20,447)	(11,792)
	-----	-----	-----	-----	-----
	1,582,920	7,818	130,635	1,721,373	1,430,483
	-----	-----	-----	-----	-----
31 December 2002	1,284,361	13,705	132,417		1,430,483
	-----	-----	-----		-----

The movements in impairment provision during the year were as follows:

	2003 US\$ '000	2002 US\$ '000
At 1 January	11,792	11,081
Charge for the year	8,023	4,679
Exchange rate adjustments/transfers	632	(3,968)
	-----	-----
At 31 December	20,447	11,792
	-----	-----

Non-trading investments include US\$494 million (2002: US\$121 million) investments sold under agreement to repurchase against which the Group had borrowings of US\$427 million (2002 : US\$109 million), included under "Due to banks and other financial institutions" and "Floating rate notes and other term debt".

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2003

7 OTHER ASSETS AND INTANGIBLES

	<i>2003</i>	<i>2002</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Interest receivable	49,546	31,025
Goodwill	28,349	29,114
Others	67,827	44,753
	-----	-----
	145,722	104,892
	-----	-----

8 CERTIFICATES OF DEPOSITS, FLOATING RATE NOTES AND OTHER TERM DEBT

	<i>Maturity</i>	<i>2003</i>	<i>2002</i>
		<i>US\$ '000</i>	<i>US\$ '000</i>
Certificates of deposits	2004	111,949	75,293
		-----	-----
Floating rate notes	2003	-	100,000
Other term debt	2004-2006	414,242	133,083
		-----	-----
		414,242	233,083
		-----	-----

9 OTHER LIABILITIES

	<i>2003</i>	<i>2002</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Interest payable	56,104	26,194
Others	140,909	102,791
	-----	-----
	197,013	128,985
	-----	-----

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2003

10 SUBORDINATED LIABILITIES

These borrowings are subordinated to the claims of all other creditors of the respective companies.

	<i>2003</i>	<i>2002</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
<i>(a) Ahli United Bank B.S.C.</i>		
Great Britain Pounds – interest at six months LIBOR plus 1%, repayable 2012	35,633	32,255
<i>(b) Ahli United Bank (U.K.) PLC</i>		
Kuwaiti Dinars – interest at six months effective KIBID, repayable 2005	10,432	10,254
US Dollars - interest at three months LIBOR plus ¾%, repayable 2007	32,775	32,775
<i>(c) UBK Finance BV</i>		
Great Britain Pounds - interest at six months LIBOR plus ¾%, repayable 2006	12,547	11,351
Great Britain Pounds - interest at six months LIBOR plus ¾%, repayable 2007	1,951	1,765
US Dollars – interest at three months LIBOR plus ¾%, repayable 2006	9,938	9,938
US Dollars – interest at three months LIBOR plus ¾%, repayable 2007	1,546	1,546
Great Britain Pounds - interest at six months LIBOR plus ¾%, 5 years and one day notice	12,080	10,928
US Dollars - interest at three months LIBOR plus ¾%, 5 years and one day notice	9,568	9,568
Kuwaiti Dinars - interest at six months KIBID, repayable 2005	2,996	2,943
	-----	-----
TOTAL	129,466	123,323
	-----	-----

11 SHARE CAPITAL

	<i>2003</i>	<i>2002</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Authorised :		
4,000 million shares of US\$ 0.25 each	1,000,000	1,000,000
	-----	-----
Issued and fully paid:		
2,600 million shares of US\$ 0.25 each	650,000	650,000
	-----	-----

12 RESERVES

a) **Share premium**

Share premium arose on rights issues in the prior years and is not available for distribution.

b) **Capital reserve**

As required by the Bahrain Commercial Companies Law, any profit on sale of treasury stock is transferred to capital reserve. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Bahrain Monetary Agency.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2003

12 RESERVES (continued)

c) **Statutory reserve**

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

d) **Proposed dividend**

The directors have proposed a cash dividend of US\$62,400 thousand (2002: US\$ 41,553 thousand) being US cents 2.4 per share (2002: US cents 2.3 per share), which will be submitted for formal approval at the Annual General Meeting.

e) **Cumulative changes in fair value**

	<i>2003</i>	<i>2002</i>
	<i>US\$'000</i>	<i>US\$'000</i>
<i>Available for sale investments</i>		
At 1 January	862	5,931
Realised during the year	(7,885)	(8,182)
Changes in fair values during the year	48,044	3,113
Share of changes in fair values of associates	15,810	-
	-----	-----
At 31 December	56,831	862
	-----	-----
<i>Cash flow hedges</i>		
At 1 January	(3,343)	(578)
Transferred to income statement	2,165	193
Changes in fair values during the year	(1,129)	(2,958)
	-----	-----
At 31 December	(2,307)	(3,343)
	-----	-----

13 FEES AND COMMISSION - NET

	<i>2003</i>	<i>2002</i>
	<i>US\$'000</i>	<i>US\$'000</i>
Fee and commission income	39,174	34,868
Fee and commission expense	(5,666)	(1,019)
	-----	-----
	33,508	33,849
	-----	-----

14 TRADING INCOME

	<i>2003</i>	<i>2002</i>
	<i>US\$'000</i>	<i>US\$'000</i>
Foreign exchange	5,523	4,412
Others	(1,419)	(626)
	-----	-----
	4,104	3,786
	-----	-----

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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15 TAXATION

	<i>2003</i>	<i>2002</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Balance sheet:		
Current asset	4,437	1,032
Deferred asset	1,740	1,994
	-----	-----
	6,177	3,026
	-----	-----
Income statement:		
Current tax on foreign operations	6,977	6,971
Deferred tax on foreign operations	254	236
	-----	-----
	7,231	7,207
	-----	-----

There is no tax on corporate income in the Kingdom of Bahrain. As of 31 December 2003, only Ahli United Bank (U.K.) PLC was subject to taxation.

The effective tax rate of Ahli United Bank (U.K.) PLC for the year ended 31 December 2003 was 32.00% (2002: 29.87%). Since there is no income tax in the Kingdom of Bahrain, reconciliation between the accounting profit and the taxable profit has not been presented.

16 BASIC EARNINGS PER SHARE

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

	<i>2003</i>	<i>2002</i>
Net profit for the year (US\$ '000)	87,076	59,726
	-----	-----
Weighted average number of shares outstanding during the year (million) *	2,600	1,807
	-----	-----
Basic earnings per share (US cents)	3.35	3.30
	-----	-----

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

17 CASH AND CASH EQUIVALENTS

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

	<i>2003</i>	<i>2002</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Cash and balances with central banks (Note 4)	26,458	21,450
Deposits with banks and other financial institutions - maturing within three months	1,198,962	803,088
	-----	-----
	1,225,420	824,538
	-----	-----

18 RELATED PARTY TRANSACTIONS

The Group enters into transactions with major shareholders, directors, senior management and companies of which they are principal owners in the ordinary course of business at arms length. All the loans and advances to related parties are performing and are free of any provision for possible loan losses. The Group has sufficient unutilised lines of credit as a back up for related party deposits.

The year-end balances in respect of related parties included in the consolidated financial statements are as follows:

	<i>2003</i>	<i>2002</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Deposits with banks and other financial institutions	25,583	29,594
Loans and advances	19,100	41,053
Non-trading investments	-	10,466
Due to banks and other financial institutions	27,461	52,524
Customers' deposits	623,100	394,055
Subordinated liabilities	67,418	49,505
Commitments and contingent liabilities	4,318	2,470

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

	<i>2003</i>	<i>2002</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Interest income	574	5,204
Interest expense	11,388	25,981
Fees and commission	1,785	1,559

19 EMPLOYEE BENEFITS

Pension scheme

Ahli United Bank (U.K.) PLC operates a funded defined benefits scheme for its employees who joined prior to 1 March 2001. The assets of the pension scheme are held independently of the Group's assets in a separate trustee administered fund.

The pension scheme is valued by independent actuaries periodically using the projected unit cost method. The latest actuarial valuation of Ahli United Bank (UK) PLC's pension scheme, carried out on 30 June 2003 revealed a deficit in the pension scheme's assets over its obligations. The principal assumptions used in the actuarial valuation were an expected investment return of 6.75% per annum, a future rate of salary progression of 4% per annum, future pension increases of 2.5% and discount rate of 6.5%.

The amounts recognised in the consolidated balance sheet are as follows:

	<i>2003</i>
	<i>US\$ '000</i>
Present value of scheme's obligations	86,223
Fair value of plan assets	(71,656)

	14,567
Unrecognised net actuarial losses	(11,698)

Liability in the balance sheet	2,869

31 December 2003

19 EMPLOYEE BENEFITS (continued)**Pension scheme (continued)**

The charge recognised in the consolidated statement of income are as follows:

	<i>2003</i>
	<i>US\$ '000</i>
Current service cost	1,350
Interest cost	5,240
Expected return on plan assets	(4,262)
Net actuarial losses recognised in the year	1,630

	3,958

The actual return on plan assets were US\$9,073 thousand (2002: loss of US\$9,533 thousand).

The movement in the liability recognised in the consolidated balance sheet during the year is as follows:

	<i>2003</i>
	<i>US\$ '000</i>
At 1 January	-
Total expenses as above	3,958
Contributions by Group	(1,089)

At 31 December	2,869

Since there was no actuarial valuation in 2002 comparative figures have not been disclosed.

Defined contribution plans

The contribution during the year for Bahraini and U.K. employees on this account amounted to US\$1,054 thousand (2002: US\$693 thousand) and US\$301 thousand (2002: US\$310 thousand) respectively.

Other defined benefit plans

The charge to the consolidated statement of income on account of end of service benefits to non-Bahraini employees of the parent and its subsidiary Ahli United Bank (Bahrain) B.S.C. (c) for the year amounted to US\$261 thousand (2002: US\$248 thousand). There are no material differences between the carrying amount of the provision for end of service benefits and the amount arising from an actuarial computation thereof.

20 MANAGED FUNDS

Funds administrated on behalf of customers to which the Group does not have legal title are not included in the consolidated balance sheet. The total market value of all such funds at 31 December 2003 was US\$1,395 million (2002 : US\$1,513 million). Effective 1 January 2002, the fund administration function has been outsourced to external fund managers and as such the Group does not have significant fiduciary risk at 31 December 2003.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2003

21 DERIVATIVES

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

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

	<i>Net fair value</i>	<i>Notional amounts by term to maturity</i>				
		<i>Total</i>	<i>Within 3 months</i>	<i>3 – 12 months</i>	<i>1 – 5 years</i>	<i>Over 5 years</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
31 December 2003:						
<i>Derivatives held for trading:</i>						
Interest rate swaps	(2,218)	1,899,781	140,486	502,235	1,257,060	-
Foreign exchange – swaps	(7,557)	3,396,580	2,735,819	657,797	2,964	-
Options	(15)	1,570,332	1,515,842	28,212	26,278	-
Interest rate futures	29	286,445	-	126,110	160,335	-
<i>Derivatives held as fair value hedges:</i>						
Interest rate swaps	(17,755)	816,056	16,306	157,176	262,878	379,696
Currency swaps	(44)	110,000	10,000	-	100,000	-
<i>Derivatives held as cash flow hedges:</i>						
Interest rate swaps	(1,980)	29,000	-	-	11,000	18,000
	-----	-----	-----	-----	-----	-----
	(29,540)	8,108,194	4,418,453	1,471,530	1,820,515	397,696
	-----	-----	-----	-----	-----	-----
31 December 2002:						
<i>Derivatives held for trading:</i>						
Interest rate swaps	(1,981)	219,186	20,000	30,000	169,186	-
Foreign exchange – swaps	(10,555)	987,622	940,269	47,269	-	84
Options	(301)	74,282	33,893	6,000	34,389	-
Interest rate futures	374	811,193	304,865	506,328	-	-
<i>Derivatives held as fair value hedges:</i>						
Interest rate swaps	(19,284)	817,816	7,032	128,952	462,073	219,759
Currency swaps	(32)	110,000	-	-	110,000	-
<i>Derivatives held as cash flow hedges:</i>						
Interest rate swaps	(2,878)	150,000	-	-	150,000	-
	-----	-----	-----	-----	-----	-----
	(34,657)	3,170,099	1,306,059	718,549	925,648	219,843
	-----	-----	-----	-----	-----	-----

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.

21 DERIVATIVES (continued)

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 and floating interest payments as well as 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.

Derivatives held for trading purposes

Most of the Group's derivative trading activities relate to positioning and arbitrage. Positioning involves managing positions with the expectation of profiting from favorable movements in prices, rates or indices. Arbitrage involves identifying and profiting from price differentials between markets or products.

Derivatives held for hedging purposes

The Group has adopted a comprehensive system for the measurement and management of risk.

As part of its asset and liability management the Group uses derivatives for hedging purposes in order to reduce its exposure to currency and interest rate risks. This is achieved by hedging specific financial instruments and forecasted transactions, as well as strategic hedging against overall balance sheet exposures.

The Group uses forward foreign exchange contracts, options and currency swaps to hedge against specifically identified currency risks. In addition, the Group uses interest rate swaps and interest rate futures to hedge against the interest rate risk arising from specifically identified fixed interest rate investments and loans. The Group also uses interest rate swaps to hedge against the cash flow risks arising on certain floating rate deposits. In all such cases the hedging relationship and objective, including details of the hedged item and hedging instrument, are formally documented and the transactions are accounted for as fair value hedges.

For strategic interest rate risk, hedging is carried out by monitoring the duration of assets and liabilities and entering into interest rate swaps and futures to hedge a proportion of the interest rate exposure. Since strategic hedging does not qualify for special hedge accounting, related derivatives are accounted for the same way as trading instruments.

22 COMMITMENTS AND CONTINGENT LIABILITIES

Credit-related commitments

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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22 COMMITMENTS AND CONTINGENT LIABILITIES (continued)

The Group has the following credit related contingencies:

	<i>2003</i> <i>US\$ '000</i>	<i>2002</i> <i>US\$ '000</i>
Contingencies on behalf of customers:		
Guarantees	313,804	251,471
Acceptances	7,465	10,790
Letters of credit	51,252	99,272
	372,521	361,533
Irrevocable commitments:		
Undrawn irrevocable loan commitments	532,477	434,698
Capital expenditure commitments	6,830	13,124
	539,307	447,822

The concentration of contingencies on behalf of customers by types of customers is as follows:

Industry sector	<i>2003</i>			<i>2002</i>
	<i>Bahrain</i> <i>US\$ '000</i>	<i>Foreign</i> <i>US\$ '000</i>	<i>Total</i> <i>US\$ '000</i>	<i>Total</i> <i>US\$ '000</i>
Banks and other financial institutions	155,208	92,936	248,144	211,955
Corporates	102,461	15,494	117,955	101,639
Others	5,982	440	6,422	47,939
	263,651	108,870	372,521	361,533

Court proceedings have been initiated by a company against a Group entity in relation to certain technical services provided in the normal course of business. Due to substantial uncertainties relating to the validity and amount of the claim its financial effect, if any, cannot be estimated at this stage. Based on the available information, the Directors are of the opinion that the claim is unlikely to result in a material loss to the Group and they intend to defend it vigorously.

At 31 December 2003, the Group had commitments under non-cancellable operating leases amounting to US\$2,281 thousand (2002: US\$2,736 thousand).

23 SEGMENT INFORMATION

Primary segment information

For management purposes the Group is recognised into three major business segments:

- Retail banking - principally handling individual customers' deposits, providing consumer loans, residential mortgages, overdrafts, credit cards and fund transfer facilities. The 2002 figures have been reclassified to include residential mortgages which were earlier included under corporate banking, treasury and investments.
- Corporate banking, treasury and investments - principally handling loans and other credit facilities, and deposit and current accounts for corporate and institutional customers and providing money market, trading and treasury services, as well as management of the Group's funding.
- Private banking and wealth management - principally servicing the high net worth clients through a range of investment products, funds, credit facilities, trusts and alternative investments.

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

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

	<i>Retail banking US\$ '000</i>	<i>Corporate banking, treasury and investments US\$ '000</i>	<i>Private banking and wealth management US\$ '000</i>	<i>Total US\$ '000</i>
Operating income before provisions	50,578	104,417	17,525	172,520
Segment result	32,206	62,711	4,997	99,914
Share of profit from associates				22,899
Unallocated costs				(4,298)
Profit for the year before provisions				118,515
Provisions				(24,208)
Net profit for the year before tax				94,307
Taxation				(7,231)
Net profit for the year				87,076
Other Information				
Segment assets	749,659	4,713,530	104,670	5,567,859
Investment in associates				501,527
Unallocated assets				200,680
Total assets				6,270,066
Segment liabilities	844,424	3,668,385	416,323	4,929,132
Unallocated liabilities				404,789
Total liabilities				5,333,921

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23 SEGMENT INFORMATION (continued)

Segment information for the year ended **31 December 2002** was as follows:

	<i>Retail banking US\$ '000</i>	<i>Corporate banking, treasury and investments US\$ '000</i>	<i>Private banking and wealth management US\$ '000</i>	<i>Total US\$ '000</i>
Operating income before provisions	41,731	92,132	19,390	153,253
Segment result	23,929	47,556	9,767	81,252
Share of profit from associates				9,779
Profit for the year before provisions				91,031
Provisions				(24,098)
Net profit for the year before tax				66,933
Taxation				(7,207)
Net profit for the year				59,726
Other Information				
Segment assets	659,969	3,823,433	62,074	4,545,476
Investment in associates				438,205
Unallocated assets				152,215
Total assets				5,135,896
Segment liabilities	846,451	2,512,396	523,298	3,882,145
Unallocated liabilities				423,136
Total liabilities				4,305,281

Secondary segment information

Although the management of the Group is based primarily on business segments, the Group operates in two geographic markets; Gulf Co-operation Council (Kingdom of Bahrain, State of Kuwait, Sultanate of Oman, State of Qatar, Kingdom of Saudi Arabia and United Arab Emirates) is designated as regional, and the remainder (Europe, U.S.A., Far East and the rest of the world) is designated as international. The following table shows the distribution of the Group's operating income and total assets by geographical segment:

	<u>Regional</u>		<u>International</u>		<u>Total</u>	
	<i>2003 US\$ '000</i>	<i>2002 US\$ '000</i>	<i>2003 US\$ '000</i>	<i>2002 US\$ '000</i>	<i>2003 US\$ '000</i>	<i>2002 US\$ '000</i>
Operating income	105,326	76,162	90,093	86,870	195,419	163,032
Total assets	2,317,273	1,785,105	3,952,793	3,350,791	6,270,066	5,135,896

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24 CREDIT RISK

Credit risk is the risk that one party to a financial instrument will fail to discharge a financial obligation and cause the other party to incur a financial loss. In case of derivatives this is limited to positive fair values. The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties.

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments, affecting a particular industry or geographic location.

The Group seeks to manage its credit risk exposure through diversification of lending activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses. It also obtains security when appropriate.

Details of the composition of the loans and advances are set out in note 5.

Details of the industry sector analysis and the geographical distribution of assets, liabilities and off balance sheet items are set out in note 25.

25 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:

	2003			2002		
	<i>Assets</i> <i>US\$ '000</i>	<i>Liabilities</i> <i>US\$ '000</i>	<i>Off balance sheet items</i> <i>US\$ '000</i>	<i>Assets</i> <i>US\$ '000</i>	<i>Liabilities</i> <i>US\$ '000</i>	<i>Off balance sheet items</i> <i>US\$ '000</i>
Geographic region:						
G.C.C. countries	2,317,273	3,590,473	2,884,499	1,785,105	2,918,021	822,925
United Kingdom	1,609,018	817,938	4,808,928	1,655,291	1,002,315	2,702,466
Europe	1,190,818	722,120	1,190,471	804,974	253,778	362,580
United States of America	597,272	15,636	74,806	465,625	22,517	13,067
Asia	101,862	4,273	11,201	64,841	3,149	24,582
Rest of the world	453,823	183,481	52,398	360,060	105,501	56,570
	6,270,066	5,333,921	9,022,303	5,135,896	4,305,281	3,982,190
Industry sector:						
Banks and other financial institutions	2,687,863	2,620,062	8,358,586	2,259,414	2,029,355	3,395,479
Real estate	707,869	150,551	122,786	676,962	68,539	89,890
Trading and manufacturing	778,228	202,700	318,767	611,438	95,414	340,701
Government/public sector	342,125	881,326	-	216,700	500,840	-
Others	1,753,981	1,479,282	222,164	1,371,382	1,611,133	156,120
	6,270,066	5,333,921	9,022,303	5,135,896	4,305,281	3,982,190
Month end average	5,486,902	4,501,186	8,388,763	4,728,518	4,161,272	4,513,602

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26 INTEREST RATE RISK

The Group's interest sensitivity position based on contractual repricing arrangements or maturity, whichever is earlier, at **31 December 2003** was as follows:

	<i>US\$ '000</i>				<i>Total</i>
	<i>Less than three months</i>	<i>Three months to one year</i>	<i>Over one year</i>	<i>Not exposed to interest rate risk</i>	
ASSETS					
Cash and balances with central banks	2,959	-	-	57,345	60,304
Trading securities	10,740	-	8,813	-	19,553
Deposits with banks and other financial institutions	1,182,833	62,568	-	14,283	1,259,684
Loans and advances	1,339,950	435,888	716,947	14,160	2,506,945
Non-trading investments	544,840	726,346	412,058	38,129	1,721,373
Investment in associates	-	-	-	501,527	501,527
Premises and equipment	-	-	-	54,958	54,958
Other assets and intangibles	-	-	-	145,722	145,722
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Total	3,081,322	1,224,802	1,137,818	826,124	6,270,066
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LIABILITIES AND EQUITY					
Due to banks and other financial institutions	1,367,109	200,344	5,000	101,615	1,674,068
Customers' deposits	1,894,806	341,700	446,947	123,730	2,807,183
Certificates of deposits	111,949	-	-	-	111,949
Floating rate notes and other term debt	113,943	300,299	-	-	414,242
Other liabilities	753	-	-	196,260	197,013
Subordinated liabilities	83,401	35,633	-	10,432	129,466
Equity	-	-	-	936,145	936,145
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Total	3,571,961	877,976	451,947	1,368,182	6,270,066
	-----	-----	-----	-----	-----
On-balance sheet gap	(490,639)	346,826	685,871		
Off-balance sheet gap	1,853,140	539,464	(2,392,604)		
	-----	-----	-----		
Total interest rate sensitivity gap	1,362,501	886,290	(1,706,733)		
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Cumulative interest rate sensitivity gap	1,362,501	2,248,791	542,058		
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26 INTEREST RATE RISK (continued)

The Group's interest sensitivity position based on contractual repricing arrangements or maturity, whichever is earlier, at 31 December 2002 was as follows:

	<i>US\$ '000</i>				
	<i>Less than three months</i>	<i>Three months to one year</i>	<i>Over one year</i>	<i>Not exposed to interest rate risk</i>	<i>Total</i>
ASSETS					
Cash and balances with central banks	2,660	-	-	49,690	52,350
Trading securities	8,980	1,851	-	-	10,831
Deposits with banks and other financial institutions	851,371	6,117	10,252	15,797	883,537
Loans and advances	1,166,658	439,012	529,651	32,954	2,168,275
Non-trading investments	566,226	102,196	677,662	84,399	1,430,483
Investment in associates	-	-	-	438,205	438,205
Premises and equipment	-	-	-	47,323	47,323
Other assets and intangibles	-	-	-	104,892	104,892
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Total	2,595,895	549,176	1,217,565	773,260	5,135,896
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LIABILITIES AND EQUITY					
Due to banks and other financial institutions	1,247,725	139,526	7,000	1,363	1,395,614
Customers' deposits	1,908,883	192,742	107,123	140,235	2,348,983
Certificates of deposits	55,293	20,000	-	-	75,293
Floating rate notes and other term debt	203,083	30,000	-	-	233,083
Other liabilities	2,900	27,909	-	98,176	128,985
Subordinated liabilities	80,816	32,255	10,252	-	123,323
Equity	-	-	-	830,615	830,615
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Total	3,498,700	442,432	124,375	1,070,389	5,135,896
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On-balance sheet gap	(902,805)	106,744	1,093,190		
Off-balance sheet gap	133,492	595,591	(729,083)		
	-----	-----	-----		
Total interest rate sensitivity gap	(769,313)	702,335	364,107		
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Cumulative interest rate sensitivity gap	(769,313)	(66,978)	297,129		
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The off-balance sheet gap represents the net notional amounts of off-balance sheet financial instruments, such as interest rate swaps, which are used to manage interest rate risk.

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or reprice in a given period. The Board measures and manages interest rate risk by establishing levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Assets and liabilities interest rate gaps are reviewed on a weekly basis and hedging strategies used to reduce the interest rate gaps to within the limits established by the Board.

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26 INTEREST RATE RISK (continued)

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 range of effective interest rates for each of the monetary financial instruments is as follows:

	2003 <i>% range</i>	2002 <i>% range</i>
<i>Assets</i>		
Treasury bills	-	1.61 - 2.06
Deposits with banks and other financial institutions	1.18 – 3.56	1.53 – 4.79
Loans and advances ^(a)	2.61 – 6.26	3.24 – 7.28
Non-trading investments	1.55 – 5.60	2.46 – 6.08
<i>Liabilities</i>		
Due to banks and other financial institutions	1.09 – 3.73	1.36 – 4.06
Customers' deposits ^(b)	0.87 – 3.57	1.61 – 3.90
Floating rate notes and other term debt	1.23 – 3.75	1.90 – 3.93
Certificates of deposits	1.29 – 3.68	2.00 – 4.03
Subordinated liabilities	1.75 – 5.26	3.19 – 5.25

(a) The effective interest rate for loans and advances has been computed including impaired loans [Note 5].

(b) The effective interest rate for customers' deposits has been computed excluding non-interest bearing accounts.

27 CURRENCY RISK

The Group views United States dollars as its measurement currency and had the following significant net exposures denominated in foreign currencies as of 31 December:

	2003 <i>US\$ '000</i> <i>long (short)</i>	2002 <i>US\$ '000</i> <i>long (short)</i>
Great Britain Pound	7,060	4,314
Bahraini Dinar	28,371	17,321
Kuwaiti Dinar	246,287	224,453
Euro	(3,221)	(516)
Others	19,095	7,242

Part of the risk management process involves managing the Group's exposure to fluctuations in foreign exchange rates (currency risk) through asset and liability management activities. It is the Group's policy to reduce its exposure to currency to acceptable levels as determined by the Board of Directors. The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

28 EQUITY PRICE RISK

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

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29 LIQUIDITY RISK

Liquidity risk is the risk that an institution 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 and assets are managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents, and readily marketable securities.

The Group Asset and Liability Committee (GALCO) monitors the maturity profile on an overall basis with ongoing liquidity monitoring by the Group treasury.

The maturity profile of the assets and liabilities at **31 December 2003** is as follows:

	<i>US\$ '000</i>			<i>Total</i>
	<i>Less than one month</i>	<i>One month to one year</i>	<i>Over one year</i>	
ASSETS				
Cash and balances with central banks	60,304	-	-	60,304
Trading securities	-	10,740	8,813	19,553
Deposits with banks and other financial institutions	1,112,552	136,701	10,431	1,259,684
Loans and advances	178,236	255,078	2,073,631	2,506,945
Non-trading investments	5,320	121,346	1,594,707	1,721,373
Investment in associates	-	-	501,527	501,527
Premises and equipment	-	-	54,958	54,958
Other assets and intangibles	12,752	62,884	70,086	145,722
	-----	-----	-----	-----
Total	1,369,164	586,749	4,314,153	6,270,066
	-----	-----	-----	-----
LIABILITIES AND EQUITY				
Due to banks and other financial institutions	997,125	671,943	5,000	1,674,068
Customers' deposits	1,952,524	773,249	81,410	2,807,183
Certificates of deposits	31,034	80,915	-	111,949
Floating rate notes and other term debt	-	-	414,242	414,242
Other liabilities	34,053	109,220	53,740	197,013
Subordinated liabilities	-	-	129,466	129,466
Equity	-	-	936,145	936,145
	-----	-----	-----	-----
Total	3,014,736	1,635,327	1,620,003	6,270,066
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29 LIQUIDITY RISK (continued)

The maturity profile of the assets and liabilities at 31 December 2002 is as follows:

	<i>US\$ '000</i>			<i>Total</i>
	<i>Less than one month</i>	<i>One month to one year</i>	<i>Over one year</i>	
ASSETS				
Cash and balances with central banks	36,080	16,270	-	52,350
Trading securities	7,956	2,875	-	10,831
Deposits with banks and other financial institutions	768,908	95,583	19,046	883,537
Loans and advances	192,347	295,298	1,680,630	2,168,275
Non-trading investments	-	142,548	1,287,935	1,430,483
Investment in associates	-	6,186	432,019	438,205
Premises and equipment	-	-	47,323	47,323
Other assets and intangibles	19,238	26,831	58,823	104,892
Total	1,024,529	585,591	3,525,776	5,135,896
LIABILITIES AND EQUITY				
Due to banks and other financial institutions	975,111	420,503	-	1,395,614
Customers' deposits	1,666,549	543,850	138,584	2,348,983
Certificates of deposits	-	75,293	-	75,293
Floating rate notes and other term debt	-	130,000	103,083	233,083
Other liabilities	21,975	54,128	52,882	128,985
Subordinated liabilities	-	-	123,323	123,323
Equity	-	-	830,615	830,615
Total	2,663,635	1,223,774	1,248,487	5,135,896

The above reflects the contractual maturities of assets and liabilities that have been determined on the basis of the remaining period at the balance sheet date to the contractual maturity date and does not take account of the effective maturities as indicated by the Group's deposit retention history and the availability of liquid funds.

30 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 their carrying values in the financial statements.

	<i>2003</i>			<i>2002</i>		
	<i>Carrying value</i>	<i>Fair value</i>	<i>Difference</i>	<i>Carrying value</i>	<i>Fair value</i>	<i>Difference</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Non-trading investments	1,721,373	1,720,129	(1,244)	1,430,483	1,422,933	(7,550)

Non-trading investments include unquoted equity investments at cost of US\$11,755 thousand (2002: US\$9,312 thousand) with a net carrying value of US\$8,321 thousand (2002: US\$7,530 thousand) after impairment provision of US\$3,434 thousand (2002: US\$1,782 thousand).

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31 CAPITAL ADEQUACY

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

	<i>2003</i>	<i>2002</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Capital base:		
Tier 1 capital	857,289	806,610
Tier 2 capital	31,409	26,129
- Eligible subordinated debts	105,161	113,787
	-----	-----
	993,859	946,526
Less: Investments in unconsolidated subsidiaries	(5,355)	(4,005)
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Total capital base (a)	988,504	942,521
	-----	-----
Risk weighted assets:		
Credit risk	4,453,073	3,716,009
Market risk	349,667	130,490
	-----	-----
Total risk weighted assets (b)	4,802,740	3,846,499
	-----	-----
Capital adequacy (a/b * 100)	21%	24%
	-----	-----
Minimum requirement	12%	12%
	-----	-----