

Ahli United Bank B.S.C.

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2004

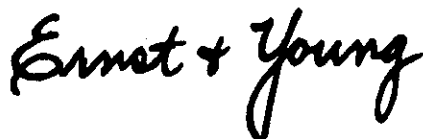
AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI UNITED BANK B.S.C.

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 2004, and the related consolidated statements of income, cash flows and changes in equity for the year then ended. These consolidated financial statements are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2004 and 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 2004 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position, and that the Bank has complied with the terms of its banking license. We obtained all the information and explanations, which we required for the purpose of our audit.



6 March 2005
Manama, Kingdom of Bahrain

Ahli United Bank B.S.C.**CONSOLIDATED INCOME STATEMENT**

Year ended 31 December 2004

	<i>Note</i>	<i>2004</i> <i>US\$ '000</i>	<i>2003</i> <i>US\$ '000</i>
OPERATING INCOME			
Interest and similar income		254,018	220,006
Interest expense and similar charges		129,166	108,063
Net interest income		124,852	111,943
Fees and commission - net	4	40,202	33,508
Trading income	5	12,162	4,104
Gains on sale of non-trading investments		16,617	9,842
Share of profit from associates	9	41,748	22,899
Other operating income		7,448	13,123
		118,177	83,476
NET INTEREST AND OTHER INCOME			
		243,029	195,419
Provision for loan losses - net	7	37,446	16,185
Provision for impairment of non-trading investments and other assets	8, 11	3,668	8,023
		41,114	24,208
OPERATING INCOME AFTER PROVISIONS			
		201,915	171,211
OPERATING EXPENSES			
Staff costs		47,605	44,193
Depreciation and amortisation		7,240	6,030
Other operating expenses		45,354	26,681
		100,199	76,904
PROFIT BEFORE TAXATION			
		101,716	94,307
Income tax credit (expense)	17	4,829	(7,231)
NET PROFIT FOR THE YEAR			
		106,545	87,076
Basic earnings per ordinary share (US cents)	18	4.10	3.35

The attached notes 1 to 35 form part of these consolidated financial statements.

Ahli United Bank B.S.C.

CONSOLIDATED BALANCE SHEET


31 December 2004

	Note	2004 US\$ '000	2003 US\$ '000
ASSETS			
Cash and balances with central banks	6	60,653	60,304
Trading securities		-	19,553
Deposits with banks and other financial institutions		2,173,056	1,259,684
Loans and advances	7	2,901,842	2,506,945
Non-trading investments	8	1,921,779	1,721,373
Investment in associates	9	820,170	501,527
Premises and equipment	10	58,150	54,958
Other assets and intangibles	11	188,414	145,722
		<u>8,124,064</u>	<u>6,270,066</u>
LIABILITIES, SUBORDINATED LIABILITIES AND EQUITY			
LIABILITIES			
Deposits from banks and other financial institutions		1,829,793	1,674,068
Customers' deposits		4,009,084	2,807,183
Certificates of deposits	12	116,724	111,949
Term debt	12	811,718	414,242
Other liabilities	13	221,941	197,013
		<u>6,989,260</u>	<u>5,204,455</u>
SUBORDINATED LIABILITIES	14	<u>134,709</u>	<u>129,466</u>
EQUITY			
Share capital	15	650,000	650,000
Reserves	16	350,095	286,145
		<u>1,000,095</u>	<u>936,145</u>
		<u>8,124,064</u>	<u>6,270,066</u>

These consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 6 March 2005.


 Fahad Al-Rajaan
 Chairman
 Board of Directors


 Hamad Al-Marzouq
 Deputy Chairman
 Board of Directors


 Adel A. El-Labban
 Group Chief Executive Officer
 & Managing Director

The attached notes 1 to 35 form part of these consolidated financial statements.

Ahli United Bank B.S.C.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2004

	2004 US\$ '000	2003 US\$ '000
OPERATING ACTIVITIES		
Profit before taxation	101,716	94,307
Adjustments for:		
Depreciation and amortisation	7,240	6,030
Gains on sale of non-trading investments	(16,617)	(9,842)
Provision for loan losses - net	37,446	16,185
Provision for impairment of non-trading investments and other assets	3,668	8,023
Share of profit from associates	(41,748)	(22,899)
Operating profit before changes in operating assets and liabilities	91,705	91,804
Changes in:		
Mandatory reserve deposits with central banks	(2,439)	(2,946)
Trading securities	19,553	(8,722)
Deposits with banks and other financial institutions	9,447	19,727
Loans and advances	(432,343)	(354,855)
Other assets and intangibles	(43,010)	(41,594)
Due to banks and other financial institutions	155,725	278,454
Customers' deposits	737,013	458,200
Certificates of deposits	4,775	36,656
Other liabilities	39,181	69,484
Cash from operations	579,607	546,208
Tax paid	(10,301)	(9,005)
Net cash from operating activities	569,306	537,203
INVESTING ACTIVITIES		
Purchase of non-trading investments	(431,715)	(742,119)
Proceeds from sale of non-trading investments	228,211	493,275
Investment in associates (Note 9)	(240,134)	(24,613)
Investment in premises and equipment	(10,114)	(12,901)
Net cash (used in) investing activities	(453,752)	(286,358)
FINANCING ACTIVITIES		
Subscription monies received towards the rights issue (Note 34)	464,888	-
Increase in subordinated liabilities	5,243	6,143
Term debt	397,476	181,159
Dividend paid	(62,400)	(41,553)
Net cash from financing activities	805,207	145,749
Foreign currency translation adjustments	(32)	4,288
INCREASE IN CASH AND CASH EQUIVALENTS	920,729	400,882
Cash and cash equivalents at 1 January	1,225,420	824,538
CASH AND CASH EQUIVALENTS AT 31 DECEMBER (Note 19)	2,146,149	1,225,420

The attached notes 1 to 35 form part of these consolidated financial statements.

Ahli United Bank B.S.C.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2004

	Ordinary share capital US\$ '000	Share premium US\$ '000	Capital reserve US\$ '000	Statutory reserve US\$ '000	Foreign currency translation adjustments US\$ '000	Retained earnings US\$ '000	Proposed appropriations US\$ '000	Cumulative changes in fair values US\$ '000	Total US\$ '000
Balance at 31 December 2002	650,000	123,752	307	14,822	(11,514)	13,858	41,871	(2,481)	830,615
Dividend 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 dividend on ordinary shares	-	-	-	-	-	(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
Dividend and other appropriations paid	-	-	-	-	-	-	(62,746)	-	(62,746)
Net profit for the year – 2004	-	-	-	-	-	106,545	-	-	106,545
Currency translation adjustments	-	-	-	-	(32)	-	-	-	(32)
Net loss on sale of available-for-sale investments (previously included in retained earnings on adoption of IAS 39)	-	-	-	-	-	435	-	-	435
Net fair value movements during the year	-	-	-	-	-	-	-	19,748	19,748
Transfer to statutory reserve	-	-	-	10,655	-	(10,655)	-	-	-
Proposed dividend on ordinary shares	-	-	-	-	-	(70,200)	70,200	-	-
Proposed directors' remuneration	-	-	-	-	-	(466)	466	-	-
Balance at 31 December 2004	650,000	123,752	307	34,185	(7,258)	54,171	70,666	74,272	1,000,095

The attached notes 1 to 35 form part of these consolidated financial statements.

Ahli United Bank B.S.C.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2004

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 retail, 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 license issued by the Bahrain Monetary Agency. The registered office of Ahli United Bank B.S.C. is located at Building 2495, Road 2832, Al Seef District 428, Kingdom of Bahrain.

The number of staff employed by the Bank and its subsidiaries (together known as the "Group") as of 31 December 2004 was 561 (31 December 2003: 568).

2 BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of Ahli United Bank B.S.C. and its subsidiaries as at the balance sheet date each year. The financial statements of subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

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

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. Where there is a loss of control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which the Group has control.

Following are the principal subsidiaries:

<u>Name</u>	<u>Country of incorporation</u>	<u>Percentage holding</u>
Ahli United Bank (U.K.) PLC	United Kingdom	100%
Ahli United Bank (Bahrain) B.S.C. (c)	Kingdom of Bahrain	100%

During the Bank's Extra-ordinary General Assembly Meeting (EGM) of shareholders held on 5 October 2004, the shareholders approved to combine the operations of the Bank's wholly owned subsidiary Ahli United Bank (Bahrain) B.S.C.(c) [AUBB], with that of the Bank. Management expect to complete the combination in the first half of 2005.

3 SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

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

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

The accounting policies, with the exception of the early adoption of IFRS 3: Business Combinations and the revised versions of IAS 36: Impairment of Assets and IAS 38: Intangible Assets are consistent with those used in the previous year.

Accounting convention

The consolidated financial statements are prepared under the historical cost convention as modified for the re-measurement at fair value of financial instruments. 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.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Early adoption of IFRS 3, IAS 36 and IAS 38

The Bank has early adopted IFRS 3 and the revised versions of IAS 36 and IAS 38. The main change arising is that goodwill ceases to be amortised and continues to be tested annually for impairment.

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 available-for-sale, held-to-maturity 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. Where a reasonable estimate of the fair value cannot be determined, the investment is carried at cost less impairment provision. 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 income statement 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 income statement to the extent of the changes in fair value being hedged.

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.

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.

Repurchase and resale agreements

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

The fair value of 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.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair values (continued)

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 that is substantially similar, or is based on the net present value of future cash flows.

The fair value of unquoted derivatives is determined either by discounted cash flows or option-pricing models.

Use of estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amount of financial assets and liabilities and disclosure of contingent liabilities. These estimates and assumptions also affect the revenues and expenses and the resultant provisions as well as fair value changes reported in equity. In particular, considerable judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required for non-performing loans as well as for impairment provisions for non-trading investments and pension liabilities. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgement and uncertainty and actual results may differ resulting in future changes in such provisions.

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 represents 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. Prior to the adoption of IFRS 3, goodwill was amortised using the straight-line method over its estimated useful life of 40 years. Following the adoption of IFRS 3, goodwill is subject to an annual impairment testing.

Premises and equipment

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

The cost of freehold land is not depreciated. Depreciation of buildings and 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 25 years
Leasehold buildings	Over the period of lease
Other premises and equipment	2 to 5 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 income statement.

Deposits

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

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.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Employee benefits

Defined benefit pension plan

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.

Defined contribution plans

The Bahraini employees of the Bank 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 Bank provides for end of service benefits for its non-Bahraini employees. The provision is based on accumulated periods of service and latest salary.

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. Derivatives are stated at fair value. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the consolidated balance sheet.

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

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 income statement in the period in which the hedged transaction impacts the consolidated income statement 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 income statement for the period.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. 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 income statement for the period.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivatives (continued)

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, accordingly, are not incorporated in the consolidated 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 is recognised using the effective interest method, 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 income statement.

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 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 reserves, plus those deposits with banks and other financial institutions and treasury bills with an original maturity of three months or less.

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 2004

4 FEES AND COMMISSION - NET

	<i>2004</i> <i>US\$ '000</i>	<i>2003</i> <i>US\$ '000</i>
Fee and commission income	45,945	39,174
Fee and commission expense	(5,743)	(5,666)
	<u>40,202</u>	<u>33,508</u>

5 TRADING INCOME

	<i>2004</i> <i>US\$ '000</i>	<i>2003</i> <i>US\$ '000</i>
Foreign exchange	9,134	5,523
Others	3,028	(1,419)
	<u>12,162</u>	<u>4,104</u>

6 CASH AND BALANCES WITH CENTRAL BANKS

	<i>2004</i> <i>US\$ '000</i>	<i>2003</i> <i>US\$ '000</i>
Cash and balances with central banks, excluding mandatory reserve deposits	24,368	26,458
Mandatory reserve deposits with central banks	36,285	33,846
	<u>60,653</u>	<u>60,304</u>

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

7 LOANS AND ADVANCES

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

Industry sector	<i>2004</i>				<i>2003</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>	%
Consumer finance	642,908	648,957	1,291,865	42.6	1,063,993	40.1
Trading and manufacturing	183,997	509,088	693,085	22.8	642,489	24.2
Real estate	46,881	403,684	450,565	14.8	470,678	17.7
Banks and other financial institutions	74,779	132,724	207,503	6.8	103,558	3.9
Government/public sector	4,514	365	4,879	0.2	5,278	0.2
Others	46,161	342,095	388,256	12.8	365,709	13.9
	<u>999,240</u>	<u>2,036,913</u>	<u>3,036,153</u>	<u>100.0</u>	<u>2,651,705</u>	<u>100.0</u>
Less: Provisions	(75,357)	(58,954)	(134,311)	(4.4)	(144,760)	(5.5)
	<u>923,883</u>	<u>1,977,959</u>	<u>2,901,842</u>	<u>95.6</u>	<u>2,506,945</u>	<u>94.5</u>

Ahli United Bank B.S.C.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2004

7 LOANS AND ADVANCES (continued)

Geographic region	2004 Total		2003 Total	
	US\$ '000	%	US\$ '000	%
G.C.C. countries	1,460,407	48.1	987,285	37.2
United Kingdom	906,395	29.9	897,861	33.9
Europe (excluding United Kingdom)	377,855	12.4	391,602	14.8
United States of America	63,563	2.1	96,252	3.6
Asia (excluding G.C.C. countries)	38,593	1.3	70,697	2.7
Others	189,340	6.2	208,008	7.8
	<u>3,036,153</u>	<u>100.0</u>	<u>2,651,705</u>	<u>100.0</u>
Less: Provisions	<u>(134,311)</u>	<u>(4.4)</u>	<u>(144,760)</u>	<u>(5.5)</u>
	<u><u>2,901,842</u></u>	<u><u>95.6</u></u>	<u><u>2,506,945</u></u>	<u><u>94.5</u></u>

Age analysis of non-performing loans as follows:

	2004			2003	
	3 months to 1 year US\$ '000	1 - 3 years US\$ '000	Over 3 years US\$ '000	Total US\$ '000	Total US\$ '000
Gross non-performing loans	62,396	23,035	45,956	131,387	161,232
Less: Provisions				(111,093)	(124,142)
Less: Interest in suspense				(9,234)	(20,618)
Net outstanding				<u><u>11,060</u></u>	<u><u>16,472</u></u>

During the year ended 31 December 2004, the Group restructured credit facilities amounting to US\$18 million (2003: US\$18 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:

	2004 US\$ '000	2003 US\$ '000
At 1 January	144,760	133,483
Amounts written off during the year	(52,679)	(10,386)
Charge for the year ^(a)	53,156	23,247
Recoveries	(15,710)	(7,062)
Interest suspended during the year	2,898	4,625
Exchange rate adjustments/ other	1,886	853
At 31 December	<u><u>134,311</u></u>	<u><u>144,760</u></u>

(a) Charge for the year includes provisions made on certain classes of performing loans that have been collectively assessed for impairment based on historical default trends.

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8 NON-TRADING INVESTMENTS

31 December 2004	2004			2003	
	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	78,692	-	-	78,692	73,658
Other government bonds and debt securities	176,031	-	55,562	231,593	224,492
Floating rate notes and certificates of deposits:					
- issued by banks and other financial institutions	755,135	-	92,423	847,558	648,806
- issued by corporate bodies	541,634	8,449	-	550,083	624,511
Equity shares	15,257	-	-	15,257	13,892
	<u>1,566,749</u>	<u>8,449</u>	<u>147,985</u>	<u>1,723,183</u>	<u>1,585,359</u>
Unquoted investments					
Bahrain government bonds and debt securities	-	-	-	-	6,682
Other government bonds and debt securities	51,776	-	69,661	121,437	32,969
Floating rate notes and certificates of deposits:					
- issued by banks and other financial institutions	5,000	-	24,921	29,921	31,562
- issued by corporate bodies	43,444	-	4,749	48,193	59,574
Equity shares at cost	9,294	-	-	9,294	11,755
Other investments	7,876	-	-	7,876	13,919
	<u>117,390</u>	<u>-</u>	<u>99,331</u>	<u>216,721</u>	<u>156,461</u>
Total	1,684,139	8,449	247,316	1,939,904	1,741,820
Less: Provision for impairment	<u>(14,575)</u>	<u>-</u>	<u>(3,550)</u>	<u>(18,125)</u>	<u>(20,447)</u>
	<u>1,669,564</u>	<u>8,449</u>	<u>243,766</u>	<u>1,921,779</u>	<u>1,721,373</u>
31 December 2003	<u>1,582,920</u>	<u>7,818</u>	<u>130,635</u>		

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

	2004 US\$ '000	2003 US\$ '000
At 1 January	20,447	11,792
Charge for the year	3,137	8,023
Amounts written off during the year	(5,422)	-
Exchange rate adjustments/other	(37)	632
At 31 December	<u>18,125</u>	<u>20,447</u>

Non-trading investments include US\$584 million (2003: US\$494 million) investments sold under agreement to repurchase against which the Group had borrowings of US\$441 million (2003: US\$427 million), included under "Due to banks and other financial institutions" and "Term debt".

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9 INVESTMENT IN ASSOCIATES

The principal associates of the Group are:

<u>Name</u>	<u>Country of incorporation</u>	<u>Percentage holding</u>
Bank of Kuwait and the Middle East K.S.C. [BKME]	State of Kuwait	48%
Ahli Bank Q.S.C. [formerly known as Al-Ahli Bank of Qatar Q.S.C.]	State of Qatar	40%
Future Bank B.S.C. (c)	Kingdom of Bahrain	33%

During the year, the Bank acquired a 40% stake in Ahli Bank Q.S.C. [formerly known as Al-Ahli Bank of Qatar Q.S.C.], a commercial bank incorporated in the State of Qatar, through 100% participation in the latter's capital increase. The Bank has also signed a ten-year (renewable) technical services agreement to provide technical and management services to Ahli Bank Q.S.C.

The Bank also, together with Bank Melli Iran and Bank Saderat Iran, formed Future Bank B.S.C. (c), a commercial bank incorporated in the Kingdom of Bahrain, with the Bank having a one-third shareholding.

10 PREMISES AND EQUIPMENT

The net book values of the Group's premises and equipment are:

	<i>2004</i> <i>US\$ '000</i>	<i>2003</i> <i>US\$ '000</i>
Freehold land and buildings	22,726	9,451
Leasehold land and buildings	26,707	26,959
Capital work-in-progress	225	10,180
Others	8,492	8,368
	<u>58,150</u>	<u>54,958</u>

11 OTHER ASSETS AND INTANGIBLES

	<i>2004</i> <i>US\$ '000</i>	<i>2003</i> <i>US\$ '000</i>
Interest receivable	68,366	49,546
Goodwill	28,032	28,349
Tax assets (Note 17)	25,207	6,177
Others	66,809	61,650
	<u>188,414</u>	<u>145,722</u>

Others include collateral pending sale with a carrying value of US\$4,509 thousand after a provision of US\$531 thousand made during the year (2003: Nil).

12 CERTIFICATES OF DEPOSITS AND TERM DEBT

	<i>Maturity</i>	<i>2004</i> <i>US\$ '000</i>	<i>2003</i> <i>US\$ '000</i>
Certificates of deposits	2005	116,724	111,949
Term debt	2005-2007	811,718	414,242

Certificates of deposits and term debts are unsecured and carry floating rate of interest payable semi-annually.

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13 OTHER LIABILITIES

	2004 US\$ '000	2003 US\$ '000
Interest payable	67,518	56,104
Accruals and deferred income	56,242	39,099
Others	98,181	101,810
	<u>221,941</u>	<u>197,013</u>

14 SUBORDINATED LIABILITIES

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

	2004 US\$ '000	2003 US\$ '000
(a) Ahli United Bank B.S.C.		
Great Britain Pounds – interest at six months LIBOR plus 1%, repayable 2012	38,646	35,633
(b) Ahli United Bank (U.K.) PLC		
Kuwaiti Dinars – interest at six months effective KIBID, repayable 2005	10,415	10,432
US Dollars - interest at three months LIBOR plus ¾%, repayable 2007	32,775	32,775
(c) AUB Finance BV		
Great Britain Pounds - interest at six months LIBOR plus ¾%, repayable 2006	13,610	12,547
Great Britain Pounds - interest at six months LIBOR plus ¾%, repayable 2007	2,116	1,951
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	13,103	12,080
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	2,992	2,996
TOTAL	<u>134,709</u>	<u>129,466</u>

15 SHARE CAPITAL

	2004 US\$ '000	2003 US\$ '000
(a) Authorised :		
▪ Ordinary Share Capital 4,000 million shares of US\$0.25 each	1,000,000	1,000,000
▪ Preference Share Capital (Note 34) 1,000 million Class A Preference Shares of US\$0.25 each	250,000	-
250 million Class B Preference Shares of US\$0.25 each	62,500	-
(b) Issued and fully paid:		
▪ Ordinary Share Capital 2,600 million shares of US\$0.25 each	650,000	650,000

16 RESERVES

a) Share premium

The share premium arose on issue of ordinary shares in the prior years and is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

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.

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 on ordinary shares

The directors have proposed a cash dividend of US\$ 70,200 thousand (2003: US\$ 62,400 thousand) being US cents 2.7 per share (2003: US cents 2.4 per share), which will be submitted for formal approval at the Annual General Meeting.

e) Cumulative changes in fair value

	<i>2004</i>	<i>2003</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
<i>Available for sale investments</i>		
At 1 January	56,831	862
Realised during the year	(5,831)	(7,885)
Changes in fair values during the year	3,111	48,044
Share of changes in fair values of associates	20,951	15,810
At 31 December	<u>75,062</u>	<u>56,831</u>
<i>Cash flow hedges</i>		
At 1 January	(2,307)	(3,343)
Transferred to income statement	(613)	2,165
Changes in fair values during the year	2,130	(1,129)
At 31 December	<u>(790)</u>	<u>(2,307)</u>

17 TAXATION

	<i>2004</i>	<i>2003</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Balance sheet:		
Current asset	22,815	4,437
Deferred asset	2,392	1,740
	<u>25,207</u>	<u>6,177</u>

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17 TAXATION (continued)

	<i>2004</i> <i>US\$ '000</i>	<i>2003</i> <i>US\$ '000</i>
Income statement:		
Current tax credit (expense) on foreign operations	4,177	(6,977)
Deferred tax credit (expense) on foreign operations	652	(254)
	<u>4,829</u>	<u>(7,231)</u>

There is no tax on corporate income in the Kingdom of Bahrain. As of 31 December 2004, only Ahli United Bank (U.K.) PLC was subject to taxation.

During 2004, tax assessments relating to a subsidiary for certain prior years were concluded with the UK Inland Revenue. This permitted a net release of US\$6.9 million in provisions no longer required.

Since there is no income tax in the Kingdom of Bahrain, reconciliation between the accounting profit and the taxable profit has not been presented.

18 EARNINGS PER ORDINARY SHARE

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

	<i>2004</i>	<i>2003</i>
Net profit for the year (US\$ '000)	<u>106,545</u>	<u>87,076</u>
Weighted average number of ordinary shares outstanding during the year (million)	<u>2,600</u>	<u>2,600</u>
Basic earnings per ordinary share (US cents)	<u>4.10</u>	<u>3.35</u>

Effective 1 January 2005, the Bank allotted 1,000 million Non-cumulative Partly Convertible preference shares that would be mandatorily converted into 500 million new ordinary shares on 1 January 2008. Since the shares were issued only on 1 January 2005, no figure for diluted earnings per ordinary share has been presented.

19 CASH AND CASH EQUIVALENTS

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

	<i>2004</i> <i>US\$ '000</i>	<i>2003</i> <i>US\$ '000</i>
Cash and balances with central banks, excluding mandatory reserve deposits (Note 6)	24,368	26,458
Deposits with banks and other financial institutions – with an original maturity of three months or less	<u>2,121,781</u>	<u>1,198,962</u>
	<u>2,146,149</u>	<u>1,225,420</u>

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20 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>2004</i>	<i>2003</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Deposits with banks and other financial institutions	102,946	25,583
Loans and advances	31,890	19,100
Due to banks and other financial institutions	28,514	27,461
Customers' deposits ^(a)	1,127,794	623,100
Subscription monies received pending allotment ^(b)	464,888	-
Subordinated liabilities	70,971	67,418
Commitments and contingent liabilities	60,044	4,318

(a) Customers' deposits include deposits from GCC government-owned institutions totalling to US\$1,117 million (2003: US\$606 million).

(b) Subscription monies represent monies received towards the pre-emptive share rights issue of Class A preference shares (refer Note 34).

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

	<i>2004</i>	<i>2003</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Interest income	3,470	574
Interest expense	18,879	11,388
Fees and commission	4,665	1,785

21 EMPLOYEE BENEFITS

Defined benefits pension plan

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 November 2004 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 6.50% per annum (2003: 6.75% per annum) a future rate of salary progression of 3.50% per annum (2003: 4.00% per annum) future pension increases of 2.75% (2003: 2.50% per annum) and discount rate of 6.00% (2003: 6.50% per annum)

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21 EMPLOYEE BENEFITS (continued)

Defined benefits pension plan (continued)

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

	2004 US\$ '000	2003 US\$ '000
Present value of scheme's obligations	114,722	86,223
Fair value of plan assets	(87,489)	(71,656)
	<u>27,233</u>	<u>14,567</u>
Unrecognised net actuarial losses	(23,782)	(11,698)
Liability in the balance sheet	<u><u>3,451</u></u>	<u><u>2,869</u></u>

The charge recognised in the consolidated income statement is as follows:

	2004 US\$ '000	2003 US\$ '000
Current service cost	1,388	1,350
Interest cost	6,028	5,240
Expected return on plan assets	(5,007)	(4,262)
Net actuarial losses recognised in the year	1,230	1,630
	<u><u>3,639</u></u>	<u><u>3,958</u></u>

The actual returns on plan assets were US\$8,382 thousand (2003: US\$9,073 thousand).

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

	2004 US\$ '000	2003 US\$ '000
At 1 January	2,869	-
Total expenses as above	3,639	3,958
Contributions by Group	(3,298)	(1,089)
Exchange rate adjustments	241	-
At 31 December	<u><u>3,451</u></u>	<u><u>2,869</u></u>

Defined contribution plans

The contribution during the year for Bahraini and U.K. employees amounted to US\$1,165 thousand (2003: US\$1,054 thousand) and US\$385 thousand (2003: US\$301 thousand) respectively.

Other defined benefit plans

The charge to the consolidated income statement on account of end of service benefits to non-Bahraini employees of the Bank for the year amounted to US\$729 thousand (2003: US\$261 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.

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22 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 2004 was US\$1,485 million (2003: US\$1,395 million). Effective 1 January 2002, the fund administration function has been outsourced to external fund managers and as such the Group does not have a significant fiduciary risk at 31 December 2004.

23 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>Notional amounts by term to maturity</i>					
	<i>Net fair value US\$ '000</i>	<i>Total US\$ '000</i>	<i>Within 3 months US\$ '000</i>	<i>3 – 12 months US\$ '000</i>	<i>1 – 5 years US\$ '000</i>	<i>Over 5 years US\$ '000</i>
31 December 2004:						
<i>Derivatives held for trading:</i>						
Interest rate swaps	1,636	3,472,103	20,325	1,697,838	1,587,858	166,082
Forward rate agreements	8,541	2,275,448	1,220,818	942,698	111,932	-
Options	972	949,066	919,020	14,588	15,458	-
Interest rate futures	(452)	1,413,877	-	1,172,339	241,538	-
<i>Derivatives held as fair value hedges:</i>						
Interest rate swaps	(17,212)	836,474	-	64,236	567,620	204,618
Currency swaps	(55)	100,000	-	100,000	-	-
<i>Derivatives held as cash flow hedges:</i>						
Interest rate swaps	(1,591)	71,200	-	10,000	22,932	38,268
Forward rate agreements	19	65,013	65,013	-	-	-
	<u>(8,142)</u>	<u>9,183,181</u>	<u>2,225,176</u>	<u>4,001,699</u>	<u>2,547,338</u>	<u>408,968</u>
31 December 2003:						
<i>Derivatives held for trading:</i>						
Interest rate swaps	(2,218)	1,899,781	140,486	502,235	1,257,060	-
Forward rate agreements	(7,589)	3,298,463	2,637,702	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
Forward rate agreements	32	98,117	98,117	-	-	-
	<u>(29,540)</u>	<u>8,108,194</u>	<u>4,418,453</u>	<u>1,471,530</u>	<u>1,820,515</u>	<u>397,696</u>

23 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 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 favourable 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.

24 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 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.

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24 COMMITMENTS AND CONTINGENT LIABILITIES (continued)

Credit-related commitments (continued)

The Group has the following credit related commitments:

	<i>2004</i>	<i>2003</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Commitments on behalf of customers:		
Guarantees	335,425	313,804
Acceptances	10,724	7,465
Letters of credit	35,928	51,252
	<u>382,077</u>	<u>372,521</u>
Irrevocable commitments:		
Undrawn irrevocable loan commitments	786,354	532,477
Capital expenditure commitments	188	6,830
	<u>786,542</u>	<u>539,307</u>

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

	<i>2004</i>			<i>2003</i>
	<i>Bahrain</i>	<i>Foreign</i>	<i>Total</i>	<i>Total</i>
Industry sector	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Banks and other financial institutions	195,510	28,928	224,438	248,144
Corporates	89,207	32,811	122,018	117,955
Others	23,594	12,027	35,621	6,422
	<u>308,311</u>	<u>73,766</u>	<u>382,077</u>	<u>372,521</u>

At 31 December 2004, the Group had capital commitments in respect of premises and equipment purchases amounting to US\$188 thousand (2003: US\$6,830 thousand) and commitments in respect of non-cancellable operating leases amounting to US\$2,710 thousand (2003: US\$2,281 thousand). Of the commitments in respect of operating leases, US\$163 thousand expire within one year (2003: US\$176 thousand), US\$950 thousand expire within two to five years (2003: US\$58 thousand) and the remaining expire over five years.

Court proceedings are in progress in respect of certain claims against the Group in the ordinary course of business. These include a claim by an entity against a Group entity in respect of provision of certain technical services. Given the interim stage of these court proceedings and the uncertainties involved, the full financial effect of these claims cannot be reliably estimated. The Directors have made provisions based on available information. In accordance with IAS 37, details are not disclosed to prevent prejudice to the outcome of such litigation.

25 SEGMENT INFORMATION

Primary segment information

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

Retail banking	- principally handling individual customers' deposits, providing consumer loans, residential mortgages, overdrafts, credit cards and fund transfer facilities.
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 high net worth clients through a range of investment products, funds, credit facilities, trusts and alternative investments.

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25 SEGMENT INFORMATION (continued)**Primary segment information (continued)**

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

Segment information for the year ended 31 December 2004 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	<u>58,141</u>	<u>159,075</u>	<u>25,813</u>	<u>243,029</u>
Segment result	<u>34,645</u>	<u>75,954</u>	<u>10,776</u>	<u>121,375</u>
Unallocated items				<u>(19,659)</u>
Net profit for the year before tax				<u>101,716</u>
Tax credit				<u>4,829</u>
Net profit for the year				<u>106,545</u>
<i>Other Information</i>				
Segment assets	<u>1,257,144</u>	<u>5,645,331</u>	<u>154,855</u>	<u>7,057,330</u>
Investment in associates				<u>820,170</u>
Unallocated assets				<u>246,564</u>
Total assets				<u>8,124,064</u>
Segment liabilities	<u>758,495</u>	<u>4,755,937</u>	<u>549,687</u>	<u>6,064,119</u>
Unallocated liabilities ^(a)				<u>1,059,850</u>
Total liabilities				<u>7,123,969</u>

- (a) Unallocated liabilities include subscription monies amounting to US\$465 million received towards Class A preference share issue (Refer note 34).

25 SEGMENT INFORMATION (continued)

Primary segment information (continued)

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

	<i>Retail banking</i> US\$ '000	<i>Corporate banking, treasury and investments</i> US\$ '000	<i>Private banking and wealth management</i> US\$ '000	<i>Total</i> US\$ '000
Operating income before provisions	50,578	127,316	17,525	195,419
Segment result	<u>32,206</u>	<u>62,711</u>	<u>4,997</u>	99,914
Unallocated items				(5,607)
Net profit for the year before tax				94,307
Tax expense				(7,231)
Net profit for the year				<u>87,076</u>
Other Information				
Segment assets	<u>749,659</u>	<u>4,713,530</u>	<u>104,670</u>	5,567,859
Investment in associates				501,527
Unallocated assets				200,680
Total assets				<u>6,270,066</u>
Segment liabilities	<u>844,424</u>	<u>3,668,385</u>	<u>416,323</u>	4,929,132
Unallocated liabilities				404,789
Total liabilities				<u>5,333,921</u>

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., Asia 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:

	<i>Regional</i>		<i>International</i>		<i>Total</i>	
	<i>2004</i> US\$ '000	<i>2003</i> US\$ '000	<i>2004</i> US\$ '000	<i>2003</i> US\$ '000	<i>2004</i> US\$ '000	<i>2003</i> US\$ '000
Operating income	<u>123,758</u>	<u>105,326</u>	<u>119,271</u>	<u>90,093</u>	<u>243,029</u>	<u>195,419</u>
Total assets	<u>3,346,883</u>	<u>2,317,273</u>	<u>4,777,181</u>	<u>3,952,793</u>	<u>8,124,064</u>	<u>6,270,066</u>

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26 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 7.

Details of the industry sector analysis and the geographical distribution of assets, liabilities and commitments on behalf of customers are set out in note 27.

27 CREDIT CONCENTRATION

The distribution of assets, liabilities and commitments on behalf of customers by geographic region and industry sector was as follows:

	2004			2003		
	<i>Assets US\$ '000</i>	<i>Liabilities US\$ '000</i>	<i>Commitments on behalf of customers US\$ '000</i>	<i>Assets US\$ '000</i>	<i>Liabilities US\$ '000</i>	<i>Commitments on behalf of customers US\$ '000</i>
Geographic region:						
G.C.C. countries	3,346,883	4,888,104	301,556	2,317,273	3,590,473	257,820
United Kingdom (U.K.)	2,115,804	808,022	6,032	1,609,018	817,938	38,336
Europe (excluding U.K.)	1,385,163	789,627	41,898	1,190,818	722,120	41,130
United States of America	515,569	63,505	3,652	597,272	15,636	1,911
Asia (excluding G.C.C.)	274,068	44,014	15,027	101,862	4,273	10,660
Rest of the world	486,577	530,697	13,912	453,823	183,481	22,664
	<u>8,124,064</u>	<u>7,123,969</u>	<u>382,077</u>	<u>6,270,066</u>	<u>5,333,921</u>	<u>372,521</u>
Industry sector:						
Banks and other financial institutions	4,174,153	3,638,632	224,439	2,687,863	2,620,062	248,144
Consumer	1,293,021	922,846	13,230	1,073,761	979,386	9,175
Trading and manufacturing	857,750	163,797	91,341	778,228	202,700	70,754
Real estate	472,703	236,431	30,028	480,655	150,551	24,059
Government/public sector	383,008	1,101,956	10,000	342,125	881,326	-
Others	943,429	1,060,307	13,039	907,434	499,896	20,389
	<u>8,124,064</u>	<u>7,123,969</u>	<u>382,077</u>	<u>6,270,066</u>	<u>5,333,921</u>	<u>372,521</u>
Month end average	<u>6,510,516</u>	<u>5,571,273</u>	<u>386,901</u>	<u>5,486,902</u>	<u>4,501,186</u>	<u>375,439</u>

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28 INTEREST RATE RISK

The Group's interest sensitivity position based on contractual repricing arrangements or maturity, whichever is earlier, at **31 December 2004** 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	2,725	-	-	57,928	60,653
Deposits with banks and other financial institutions	2,121,729	36,967	-	14,360	2,173,056
Loans and advances	1,643,051	362,517	886,586	9,688	2,901,842
Non-trading investments	529,001	154,693	1,206,730	31,355	1,921,779
Investment in associates	-	-	-	820,170	820,170
Premises and equipment	-	-	-	58,150	58,150
Other assets and intangibles	-	-	-	188,414	188,414
Total	4,296,506	554,177	2,093,316	1,180,065	8,124,064
LIABILITIES AND EQUITY					
Due to banks and other financial institutions	1,598,288	203,822	21,834	5,849	1,829,793
Customers' deposits	2,873,778	269,651	229,850	635,805	4,009,084
Certificates of deposits	116,724	-	-	-	116,724
Term debt	811,718	-	-	-	811,718
Other liabilities	-	-	-	221,941	221,941
Subordinated liabilities	85,647	38,646	-	10,416	134,709
Equity	-	-	-	1,000,095	1,000,095
Total	5,486,155	512,119	251,684	1,874,106	8,124,064
On-balance sheet gap	(1,189,649)	42,058	1,841,632		
Off-balance sheet gap	(721,788)	690,802	30,986		
Total interest rate sensitivity gap	(1,911,437)	732,860	1,872,618		
Cumulative interest rate sensitivity gap	(1,911,437)	(1,178,577)	694,041		

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28 INTEREST RATE RISK (continued)

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>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	2,959	-	-	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
Total	3,081,322	1,224,802	1,137,818	826,124	6,270,066
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
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
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)		
Cumulative interest rate sensitivity gap	1,362,501	2,248,791	542,058		

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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28 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 weighted average effective interest rates for each of the monetary financial instruments is as follows:

	<i>2004</i>	<i>2003</i>
<i>Assets</i>		
Deposits with banks and other financial institutions	1.5%	1.9%
Loans and advances ^(a)	6.3%	6.0%
Non-trading investments	4.0%	4.2%
<i>Liabilities</i>		
Due to banks and other financial institutions	2.6%	3.5%
Customers' deposits ^(b)	2.3%	1.7%
Certificates of deposits	3.8%	2.8%
Term debt	1.9%	2.5%
Subordinated liabilities	4.4%	2.7%

(a) The weighted average effective interest rate for loans and advances has been computed including impaired loans [Note 7].

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

29 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:

	<i>2004</i>	<i>2003</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
	<i>long (short)</i>	<i>long (short)</i>
Kuwaiti Dinar	316,691	246,287
Qatari Riyal	199,511	164
Bahraini Dinar	87,795	28,371
Great Britain Pound	16,576	7,060
Euro	3,923	(3,221)
Others	20,993	18,931

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.

30 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.

31 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 has 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 2004** is as follows:

	<i>Up to one month</i>	<i>One month to three months</i>	<i>Over three months to one year</i>	<i>Over one year to five years</i>	<i>Over five years</i>	<i>Total</i>
ASSETS						
Cash and balances with central banks	60,653	-	-	-	-	60,653
Deposits with banks and other financial institutions	1,956,014	177,085	39,957	-	-	2,173,056
Loans and advances	118,118	78,165	232,391	1,296,467	1,176,701	2,901,842
Non-trading investments	49,548	32,783	209,216	1,241,220	389,012	1,921,779
Investment in associates	-	-	-	-	820,170	820,170
Premises and equipment	-	-	-	-	58,150	58,150
Other assets and intangibles	20,548	11,372	88,899	16,468	51,127	188,414
Total	2,204,881	299,405	570,463	2,554,155	2,495,160	8,124,064
LIABILITIES AND EQUITY						
Due to banks and other financial institutions	946,095	580,750	203,822	99,126	-	1,829,793
Customers' deposits	2,686,767	850,486	269,653	143,095	59,083	4,009,084
Certificates of deposits	39,661	77,063	-	-	-	116,724
Term debt	-	-	23,588	788,130	-	811,718
Other liabilities	59,383	31,747	76,395	28,417	25,999	221,941
Subordinated liabilities	-	13,407	-	59,984	61,318	134,709
Total	3,731,906	1,553,453	573,458	1,118,752	146,400	7,123,969
Net liquidity gap	(1,527,025)	(1,254,048)	(2,995)	1,435,403	2,348,760	1,000,095

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

	<i>Up to one month</i>	<i>One month to three months</i>	<i>Over three months to one year</i>	<i>Over one year to five years</i>	<i>Over five years</i>	<i>Total</i>
Total assets	1,369,164	240,463	346,286	2,011,421	2,302,732	6,270,066
Total liabilities	3,014,736	1,047,823	587,504	589,980	93,878	5,333,921
Net liquidity gap	(1,645,572)	(807,360)	(241,218)	1,421,441	2,208,854	936,145

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.

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32 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.

	2004			2003		
	<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	1,921,779	1,922,505	726	1,721,373	1,720,129	(1,244)

Non-trading investments include unquoted equity investments at cost of US\$9,294 thousand (2003: US\$11,755 thousand) with a net carrying value of US\$5,160 thousand (2003: US\$8,321 thousand) after impairment provision of US\$4,134 thousand (2003: US\$3,434 thousand).

Investments in associates include investments in BKME and Ahli Bank Q.S.C. that are quoted on Kuwait and Qatar stock exchanges respectively. As at 31 December 2004, the value of the Group's investments in BKME and Ahli Bank Q.S.C. at exchange traded prices stood at US\$927 million with a carrying value of US\$785 million.

33 CAPITAL ADEQUACY

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

	2004	2003
	<i>US\$ '000</i>	<i>US\$ '000</i>
Capital base:		
Tier 1 capital	1,010,726	852,670
Tier 2 capital	484,156	135,834
Total capital base (a)	1,494,882	988,504
Risk weighted assets (b)	6,307,943	4,802,740
Capital adequacy (a/b * 100)	23.7%	20.6%
Minimum requirement	12.0%	12.0%

34 ISSUE OF PREFERENCE SHARES

Following the shareholders' approval at the Bank's EGM held on 5 October 2004, the Bank has raised net preference share issue proceeds of US\$443 million, on a pre-emptive rights basis, through an allotment of 1,000 million Class A preference shares, effective 1 January 2005.

The Class A preference shares represent "Non-Cumulative Partly Convertible Preference Shares". 50% of Class A preference shares are mandatorily convertible on 1 January 2008 into an equal number of ordinary shares (adjusted for any bonus share issues) of par value US\$0.25 each at a price of US\$0.45 per share which will result in the issuance of 500 million new ordinary shares. The remaining 50% of the Class A preference shares are redeemable in cash on 1 January 2015, or at an earlier date after 1 January 2010 if exercised by the Bank, at US\$ 0.45 per share. The Class A preference shares carry a dividend at a rate equal to 1.50% over twelve-month US Dollar LIBOR, payable annually. The payment of dividends on preference shares is subject to recommendation by the Board of Directors and approval by the General Assembly of ordinary shareholders.

34 ISSUE OF PREFERENCE SHARES (continued)

The Class B preference shares represent “Non-Cumulative Fully Convertible Preference Shares” with a nominal value of US\$0.25 each authorised for issuance to the employees of the Bank under a future Employees’ Share Purchase Plan in one or more tranches over a five-year period at prices set by the Board of Directors, subject to regulatory consents.

After conversion of both Class A and Class B preference shares, the resultant ordinary shares will rank pari-passu with the ordinary shares in issue. The Class A preference shares not subject to conversion would receive preferential treatment over ordinary shares and Class B preference shares, but shall be subordinated to all other liabilities of the Bank.

35 DEPOSIT PROTECTION SCHEME

Certain customers’ deposits of the Group are covered by deposit protection schemes established by the Bahrain Monetary Agency and the Financial Services Compensation Scheme, U.K. The schemes apply to all non-banking private sector deposits subject to specific exclusions mainly relating to maximum deposit amounts, maximum total amount covered in one calendar year and maximum total amount of the Deposit Protection Board’s financial resources. No up-front contribution is required to the scheme and no liability is due until the Bank or any of its subsidiaries is unable to meet its depository obligations.