

2007 ANNUAL REPORT



AL SALAM BANK

Bahrain البحرين



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HIS HIGHNESS
SHAIKH KHALIFA BIN SALMAN
AL KHALIFA

The Prime Minister
The Kingdom of Bahrain



HIS MAJESTY
KING HAMAD BIN ISA
AL KHALIFA

The King of
The Kingdom of Bahrain



HIS HIGHNESS
SHAIKH SALMAN BIN HAMAD
AL KHALIFA

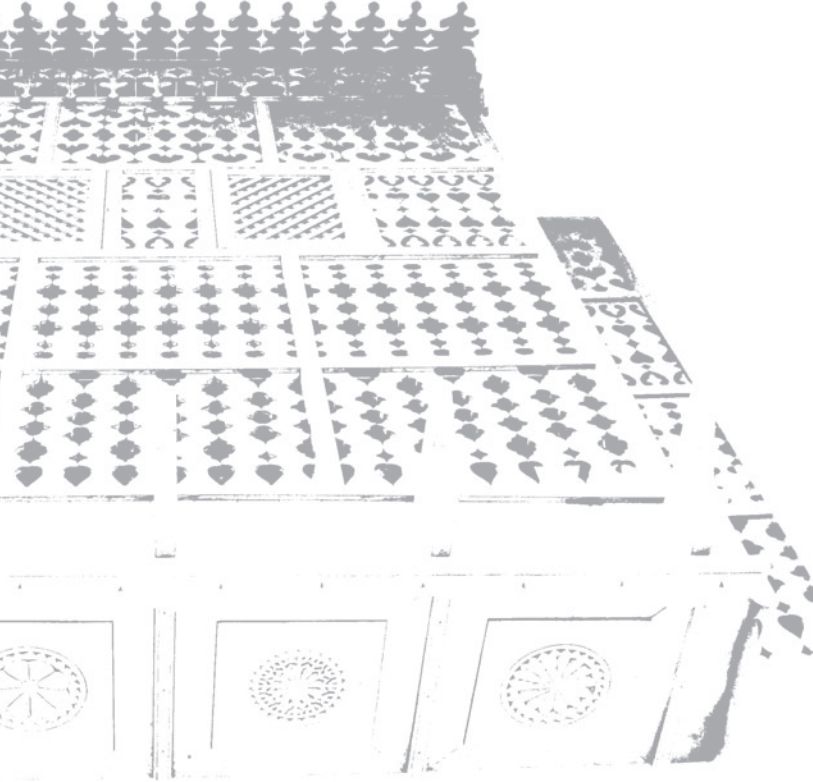
The Crown Prince and
Deputy Supreme Commander



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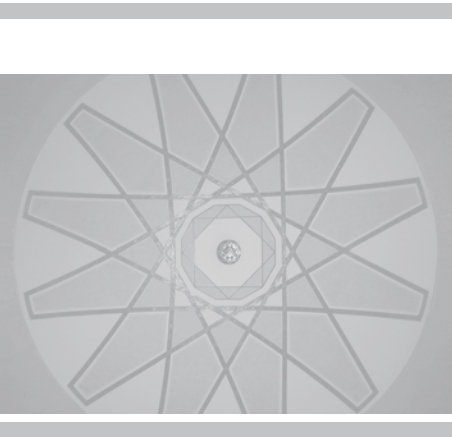
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AL SALAM BANK

البحرين Bahrain



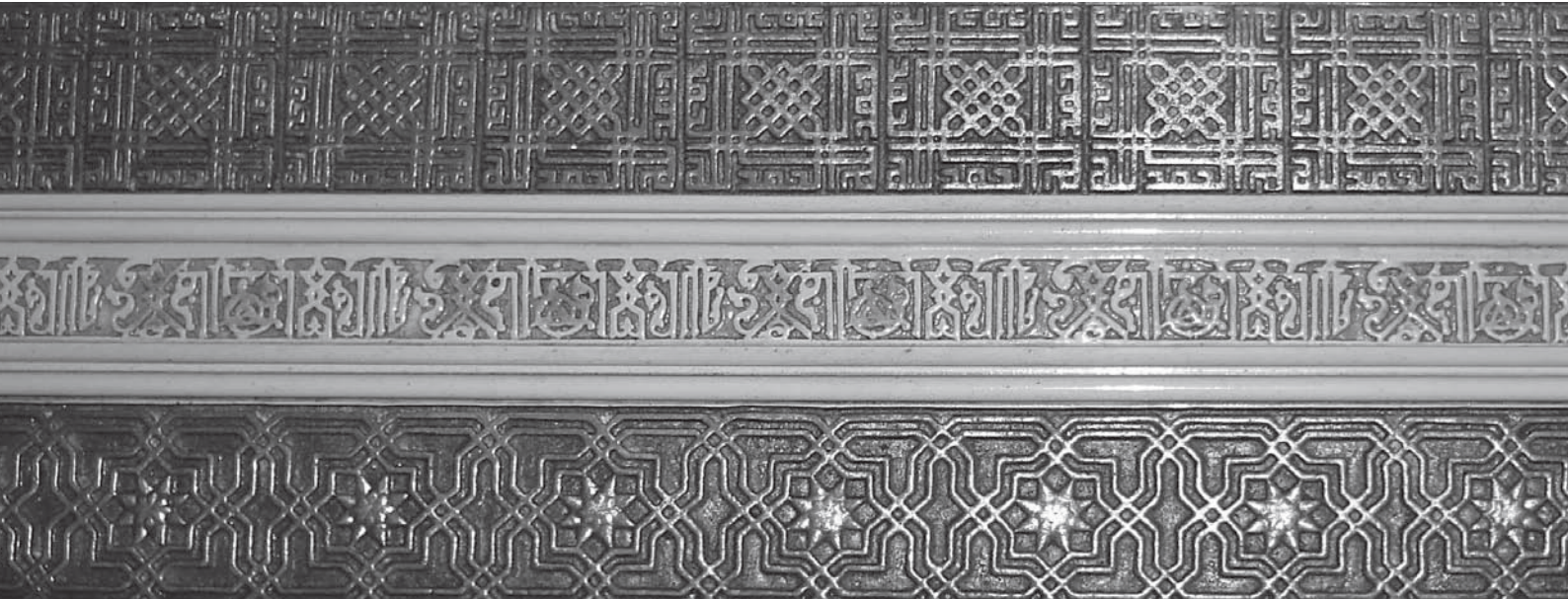
OUR VISION

To become a global force in the Islamic financial services industry by providing innovative, tailor-made Shari'a compliant products. Building a reputation as a "Trusted Bank" whilst enhancing shareholder value.

OUR MISSION

- Become the one-stop-shop for providing differentiated Islamic financial products to specific target segments.
- Build a strong global presence and premier brand image as an Islamic financial shaper.
- Achieve high returns for investors and shareholders based upon specific risk appetites.

CORPORATE OVERVIEW



Incorporated on 19 January 2006 in the Kingdom of Bahrain, with a paid-up capital of BD120 million (US\$317 million), Al Salam Bank-Bahrain commenced commercial operations on 17 April 2006. The Bank operates under Islamic Shari'a principles and in accordance with regulatory requirements for Islamic banks set by the Central Bank of Bahrain. The Bank is listed on the Bahrain Stock Exchange.

The founding shareholders of the Bank subscribed to 65 per cent of the paid-up capital. They include leading regional institutions such as Emaar Properties, Amlak Finance, Dubai Holding, Dubai Investment Group and Global Investment House, together with other strategic shareholders from across the Middle East.

The Bank is committed to adopting internationally-recognised standards and best practices in critical areas such as corporate governance, compliance, risk management and banking operations with the highest levels of integrity, transparency and trust.

Additionally the Bank is equally committed to its role as a concerned corporate citizen, actively seeking ways to contribute and add value to the social and economic well-being of the local communities in which it invests and operates.

ANNUAL HIGHLIGHTS

KEY FINANCIAL INDICATORS 2007

Total Operating Income

BD33.9 million

(US\$90.2 million)



BD20.4 million

(US\$54.3 million)

Net Profit

BD23.1 million

(US\$61.4 million)



BD16.4 million

(US\$43.6 million)

Return on Average Equity

17.0%



15.1%

Earnings Per Share

19.3 Fils



15.1 Fils

Total Assets

BD397.8 million (US\$1,057.9 million)



BD188.1 million

(US\$500 million)

Total Equity

BD159.5 million (US\$424.2 million)



BD136.5 million

(US\$363 million)



The Bank has successfully overcome the challenges of a start-up entity in just under two years of establishment while posting net profits from operations in both years.

BOARD OF DIRECTORS

H. E. MOHAMED ALI RASHID ALABBAR

Chairman

Mohamed Ali Alabbar is the founding member and Chairman of Emaar Properties PJSC, the Dubai-based global property developer. He chairs John Laing Homes in the USA, Hamptons International in the UK and a joint venture with Italy's Giorgio Armani to set up a global Armani-branded luxury hotel and resort chain. He is member of the Dubai Executive Council, and serves on the board of directors of the Investment Corporation of Dubai (ICD), the investment arm of the Government of Dubai. He is also a Board Member of Noor Investment Group, an affiliate of Dubai Group, focused on Shari'a compliant financial services. A graduate in Finance and Business Administration from Seattle University in the United States, Mr. Alabbar works closely with regional NGOs, and is especially committed to the cause of educational reform and social housing. A keen sportsman, he is Chairman of the UAE Golf Association.



HUSSEIN MOHAMMED AL MEEZA

Vice Chairman, Chairman of the Executive Committee

Hussein Al Meeza is one of the brightest names in the UAE's financial and banking sectors, particularly in the area of Islamic finance and insurance. Having graduated from the Beirut Arab University in 1975, Al Meeza started his professional career at the Dubai Islamic Bank (DIB). His outstanding career success was crowned in December 2006 when the International Conference of Islamic Bankers chose him as the 2006 Best Islamic Banking Personality. Al Meeza is currently CEO, Managing Director of Aman Insurance and Re-Insurance Company, Vice Chairman of Al Salam Bank-Sudan, Vice Chairman & the Chairman of the Executive Committee of Al Salam Bank-Algeria, Vice Chairman of Leader Capital, Chairman of Gulf Jet, Board Member of Emaar Industries & Investments, Member of the Islamic Finance Advisory Council-Dubai International Financial Centre (DIFC), Board Member of the Banking Committee and Islamic Financial Association and Chairman of the founding committee of Islamic Insurance and Re-Insurance Companies.

ESSAM AL MUHAIDEB

Member

Mr. Essam Al Muhaideb is Group Managing Director of A.K. Al Muhaideb & Sons; Managing Director and the Chairman of Al Muhaideb Foods company, and Chairman of Giant Stores and United Group Central Markets, which are all based in Saudi Arabia. He is also the Vice Chairman of DNATA, Kuwait. He is also the Vice Chairman of Gulf Union Insurance Company, and board member of Mashaer Company (Kuwait), Nama Group (Qatar), Teeba Holding Company (Lebanon), Gef Holding Company (Switzerland), VeeTee Investment Corporation (UK), Al Massa International (Canada) and Reem Rice Mills Limited (Pakistan).



BOARD OF DIRECTORS

HABIB AHMED KASSEM

Member

Mr. Habib Kassem is the Chairman of Almahd Investment Company, Bahrain Ferro Alloys, Bahrain Electricity Supply & Transmission Company, Capital Growth Management and Quality Wire Products Company. He is also the Chairman of Almahd Day Boarding School. Mr. Kassem was a Member of the GCC Consultative Council for the Supreme Council from 1997-2007.



MOHAMMED BIN OMEIR YUSSEF AL MEHAIRI

Member

Mr. Mohammed Bin Omeir is currently the Chief Executive Officer of Bin Omeir Holding Group. He is also a Board member of Dubai Islamic Insurance and Re-Insurance Company (Aman), Al Salam Bank-Sudan and Al Salam Bank-Algeria.

OMAR MAHMOOD AL-QUQA

Member

Mr. Omar Al-Quqa is a Chartered Financial Analyst (CFA), and a co-founder and Executive Vice President, Corporate Finance & Treasury, of Kuwait-based Global Investment House. He is the Chairman of Jordan Trade Facilities Company. His Vice Chairmanships include: Housing Finance Company (ISKAN) and Iraq Holding Company (both based in Kuwait); Arabian Seas Insurance Company (Jordan) and Bahrain-based Real Estate Finance Company (Reef). He is also a Board Member of the following companies: Al-Manar Finance & Ijara (Kuwait), Bahrain-based Khaleej Development Company (Tameer), United Finance Company (Oman), Baghdad Bank (Iraq), Al Salam Bank - Sudan, Investment Funds Company (Jordan) and the regional office of Palestine Public Real Estate Company in Jordan.



BOARD OF DIRECTORS

SALEH SAEED AHMED LOOTAH

Member

Mr. Saleh Lootah is currently the Group Executive Director of the S.S. Lootah Group, Dubai. Mr. Lootah is Executive Committee Member of Dubai Council for Economic Affairs, a Board member and Chairman of Credit Committee at Dubai Islamic Bank. He is Member Board of Directors of Amlak Finance PJSC (Dubai), Amlak International, Riyadh (KSA), Dubai Islamic Insurance & Reinsurance Company (Aman). He is also the Managing Director of Dubai Co-operative Society (Al Islamic Foods) and a member of the Board of Trustees of Dubai Medical College for Girls. Mr. Lootah is a graduate in Islamic Banking from the Islamic School for Training & Education, Dubai.



SALEM RASHED SAEED AL MOHANNADI

Member

Mr. Salem Al Mohannadi is currently the Executive Director of Finance and Administration Department of Abu Dhabi Investment Authority, Chairman of Tunis and Emirates Bank, Deputy Chairman of Abu Dhabi Holding Company. He is also a Board member of Al Salam Bank-Sudan, Al Salam Bank-Algeria and Emaar Properties, Dubai Islamic Bank, Abu Dhabi Islamic Bank, Abu Dhabi Investment Company, Arab Investment Company-Riyadh, Arab Jordan Investment Bank-Amman and Arab International Investment Bank-Cairo.

KHALID AHMED ABDULLA AL ASHAR

Secretary to the Board

Mr. Khalid Al Ashar enjoys a vast experience that extends to 27 years. In addition to his previous work within the public sector, Mr. Al Ashar held a number of positions at the banking sector. He previously worked in the Operations Department at the Bank of Bahrain and Kuwait and Arab Banking Corporation. He also held the position of Director of Human Resources and Administration at the Liquidity Management Centre. He enjoys a long experience in the field of establishing Islamic banks and contributed in the establishment of the Liquidity Management Center. Mr. Al Ashar holds a BSc in Commerce and Business Administration from Beirut Arab University.





The Shari'a Board has conducted various meetings with the Bank's Management and acknowledged that they have been complying with the principles of Islamic Shari'a and the Board's Fatwas

SHARI'A SUPERVISORY BOARD

DR. HUSSAIN HAMID HASSAN

Chairman

Dr Hassan holds a Ph.D. from the Faculty of Shari'a, Al Azhar University, Cairo, Egypt and a Masters in Comparative Jurisprudence and Diploma in Comparative Law (both of which are the equivalent of a Ph.D.) from the International Institute of Comparative Law, University of New York, USA. He also holds a Masters in Comparative Juries, Diplomas in Shari'a and Private Law, from the University of Cairo and an LLB in Shari'a from Al Azhar University. He is the Chairman and member of the Shari'a Supervisory Board in many of the Islamic Financial Institutions. In addition, Dr. Hassan is Chairman of the Assembly of Muslim Jurists, Washington, USA, a member of the European Islamic Board for Research & Consultation, Dublin, Ireland and an Expert at the Union of Islamic Banks, Jeddah, Kingdom of Saudi Arabia.

DR. ALI MOHIUDDIN AL QURRA DAGHI

Member

Dr. Al Qurra Daghi holds a Ph.D. in Shari'a and Law, and a Masters in Shari'a and Comparative Fiqh from Al Azhar University, Cairo, Egypt. He also holds a BSc. in Islamic Shari'a from Baghdad University, Iraq, a certificate of traditional Islamic Studies under the guidance of eminent scholars in Iraq and is a graduate of the Islamic Institute in Iraq. He is currently Professor of Jurisprudence in the Faculty of Shari'a Law and Islamic Studies at the University of Qatar. He sits on the Boards of Shari'a Supervisory Boards for several banks and financial institutions. Dr. Al Qurra Daghi is also a member of the Islamic Fiqh Academy, the Organisation of Islamic Conference, the European Muslim Council for Efta and Researches, the International Union of Muslim Scholars and the Academic Advisory Committee of the Islamic Studies Centre, Oxford University, UK. He published several research papers tackling various types of Islamic Finance, Islamic Fiqh, Zakah and Islamic Economy.

SHAIKH ADNAN ABDULLA AL QATTAN

Member

Shaikh Adnan Al Qattan holds Masters degree in the Quran and Hadith from the University of Um Al-Qura, Makka, Kingdom of Saudi Arabia and Bachelor's degree in Islamic Shari'a from the Islamic University, Madeena, Saudi Arabia. Shaikh Al Qattan is also a Judge in the Shari'a Supreme Court, Ministry of Justice – Kingdom of Bahrain. He is a Member of Shari'a Supervisory Boards for several Islamic banks and is also Chairman of Al Sanabil Orphans Protection Society, Chairman of the Board of Trustees of the Royal Charity Establishment under the Royal Court, Kingdom of Bahrain and President of the Kingdom of Bahrain Hajj Mission. In addition, he is a Friday sermon orator at Al-Fatih Grand Mosque. Shaikh Al Qattan contributed to drafting the Personal Status Law for the Ministry of Justice and is a regular participant in Islamic committees, courses, seminars and conferences.

DR. MOHAMED ABDUL HAKIM ZOEIR

Member & Board Secretary

Dr. Zoeir holds Ph.D. in Islamic Economy, Masters degree in Islamic Shari'a (Economy), Bachelor's degree in Management Sciences and a Higher Diploma in Islamic Studies. He is Member of the Fatwa Board in a number of Islamic financial institutions and has 18 years experience with Egypt Central Bank. Dr. Zoeir was also the Head of Shari'a compliance at Dubai Islamic Bank.

EXECUTIVE MANAGEMENT



DR. OMAR MARWAN KAMAL



MOHAMMED PARACHA



DR. HASAN MAHMOOD AL BASTAKI

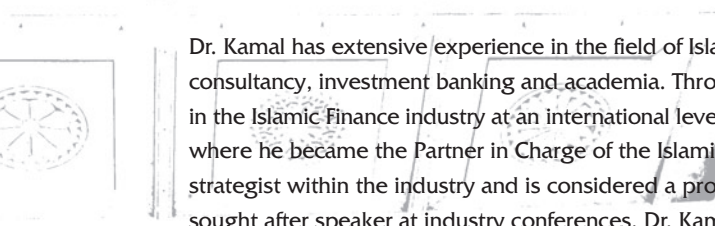


MARCO DONDI



DR. OMAR MARWAN KAMAL

Executive Vice President, Investments Group Head



Dr. Kamal has extensive experience in the field of Islamic Financial Services, and his career to date has embraced financial consultancy, investment banking and academia. Through his diversified exposure, Dr. Kamal established a strong network in the Islamic Finance industry at an international level. He joined Al Salam Bank - Bahrain after working for Ernst & Young, where he became the Partner in Charge of the Islamic Financial Services Group (IFSG). He is recognized as a leading strategist within the industry and is considered a prominent figure in contemporary Islamic financial markets. A highly sought after speaker at industry conferences, Dr. Kamal is also a frequent contributor to international media.

MOHAMMED PARACHA

Executive Vice President, General Counsel

A qualified Solicitor (English Law), Mr. Paracha holds a Bachelor degree in Law (LL B Hons.) from Brunel University, UK and a Postgraduate Diploma in Law from the College of Law, UK. He was Partner Designate at the international law firm Norton Rose. Notable career achievements by Mr. Paracha include being named as 'Lawyer of the Year' in 2004 and in their Hot 100 list in 2007 by the prestigious legal publication, The Lawyer. He served as a member of the Bank of England Working Party on Islamic Finance, assisted in the formation of the Islamic Bank of Britain, and advised Lloyds TSB on the establishment of an Islamic banking window.

DR. HASAN MAHMOOD AL BASTAKI

Executive Vice President, Operations, IT and Support Services Group Head

Dr. Al Bastaki holds a Ph.D. in Accounting from the University of North Texas, USA. He has over 21 years' experience of working in the Kingdom of Bahrain and North America. He was Secretary General of the Bahrain Centre for Studies and Researches. His private sector experience includes senior management and specialist positions with one of the international auditing firms. In the academic world, Dr. Al Bastaki was Vice President for Finance & Administration at the University of Bahrain. Dr. Al Bastaki is an Arbitrator and Expert at the Bahrain-based GCC Commercial Arbitration Centre and was appointed by a Royal Decree as a member in the Bahrain Tender Board for the period from 2003 to 2007.

MARCO DONDI

Senior Vice President, Head of Treasury and Capital Markets

Mr. Dondi has over 21 years' regional and international banking experience, specialising in treasury, money markets, derivatives trading, and bonds. He was Chief Dealer and Deputy Treasurer at BNP Paribas Bahrain, where he held a global mandate for trading, marketing and sales on GCC and North African currencies. Before this, Mr. Dondi spent four years with Kuwait-based Gulf Bank and eight years with the Brussels branch of Sumitomo Bank.

BOARD OF DIRECTORS' REPORT TO THE SHAREHOLDERS



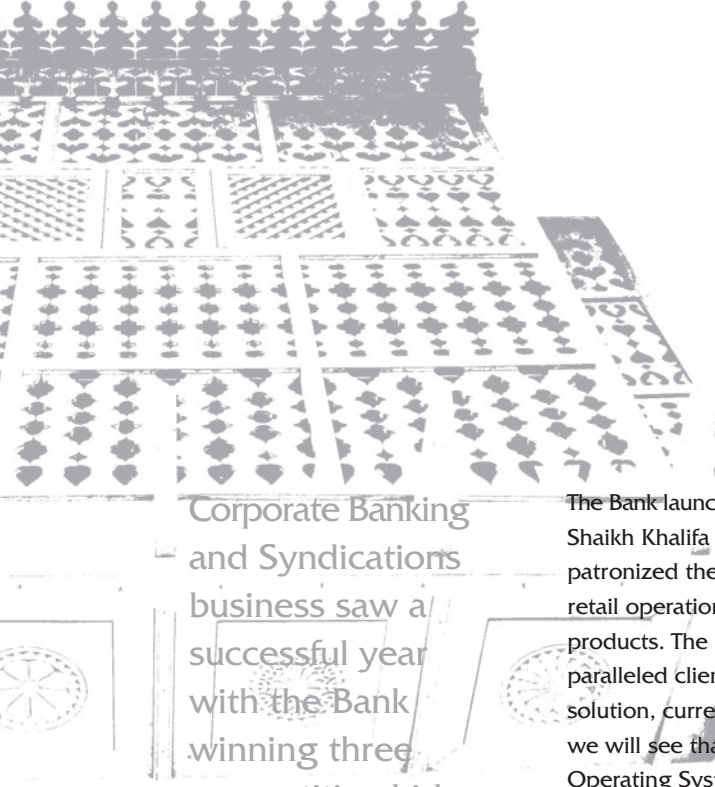
In the name of Allah, the Beneficent, the Merciful, Prayers and Peace Be Upon the Last Apostle and Messenger, our Prophet Mohammed.

On behalf of the Members of the Board of Directors, I have the pleasure in submitting the Annual report for the year ended 31 December 2007.

The first full year of commercial operations had been very successful with the Bank's total assets reaching BD397.8 million, crossing the US dollar one billion mark, as of 31 December 2007 and net profit of BD23.1 million (US\$61.4 million) for 2007 showing an increase of 41% over 2006. This is your Bank's second profitable year since its inception in January 2006 despite many challenges and difficulties a new Bank undergoes during the establishment phase. Although the last quarter of 2007 saw credit squeeze and liquidity tightening due to the sub-prime crisis and fears of US economy stagnation, the Bank managed to post impressive growth in both total assets and net income.

In 2007, the Board and the senior management continued their efforts in completing the establishment of key pillars of the Bank's infrastructure with people, policies and systems being the focus on all aspects of the business. The implementation of the core banking application and the establishment of risk management framework received further impetus and the Bank is now fully positioned to meet the challenges of Basel II which is expected to be implemented by the Central Bank of Bahrain during 2008.

The Directors are pleased to highlight that your Bank has successfully overcome the challenges of a start-up entity in just under two years of establishment while posting net profits from operations in both years.



Corporate Banking and Syndications business saw a successful year with the Bank winning three competitive bids to finance in aggregate BD62.4 million (US\$166 million) to the Government of Bahrain and its entities.

The Bank launched its retail operations in May 2007 immediately after His Highness Shaikh Khalifa Bin Salman Al-Khalifa, Prime Minister of the Kingdom of Bahrain, patronized the opening of the Bank's operations on 17 May 2007. The launch of retail operations was followed by the rollout of retail distribution channels and products. The Board and the management have recognized the need to offer unparalleled client service and to this end has implemented an internet banking solution, currently available to clients on a selective basis. The next few months we will see that this service is available to all clients with compatibility to all Operating Systems.

The Bank installed in its Al-Seef main branch Automated Teller Machines (ATM's) which are linked to the Bahrain's Benefit Switch and the GCC Net. The Bank launched EMV embedded Islamic debit cards, the first by any bank in Bahrain, during the year. The last quarter of 2007 saw the launch of Al Salam Wakala Deposit, a private banking and retail investment product for the investors. The product gives investors competitive yields in the marketplace reflecting the yields on the related underlying assets whilst offering flexibility to the Bank in terms of deployment of the funds derived from those unrestricted investment deposits.

Corporate Banking and Syndications business saw a successful year with the Bank winning three competitive bids to finance in aggregate BD62.4 million (US\$166 million) to the Government of Bahrain and its entities. Your Bank was cautious in building assets bearing in mind the need for asset quality and to be on top of liquidity in the current banking environment after the US sub-prime crisis.

The weakening of the US dollar in 2007 against major currencies and market views on the future of the peg of GCC currencies to the US dollar posed further challenge to the management in addition to the task of raising interbank lines and managing liquidity. Hence, the management had been prudent in running US dollar long position keeping in mind the possibility of a potential revaluation of the GCC currencies against the US dollar in order to minimise the impact of any potential revaluation of the GCC currencies. This coupled with the lack of competitive Shari'a compliant hedging instruments to hedge the potential foreign exchange risk posed a major challenge to the management in acquiring corporate assets as the market requirements have predominantly been in US dollars.

The Board and the management are both focussed on sourcing attractive private equity deals with emphasis on alternative energy, aviation, healthcare and real estate sectors. In 2006 the Board resolved to expand the scope of the Bank's activities to include investment banking activities to cover private equity investments in certain sectors of focus. Following this decision, management concluded a US\$34 million transaction representing 100% equity in a Boeing 777 200-ER aircraft on lease to Malaysian Airline Systems. This transaction was successfully placed with investors with the Bank retaining a strategic stake.

BOARD OF DIRECTORS'

REPORT TO THE SHAREHOLDERS (Continued)

2007 had seen impressive growth in net profit from BD16.4 million posted in 2006 to BD23.1 million

In addition, the Bank successfully concluded an 80% participation in a private equity fund for US\$50 million with underlying being significant minority stakes in Chinese manufacturing, food and consumer goods industries. In addition, your Bank has secured a number of attractive real estate transactions in the GCC and in South East Asia which offer competitive risk-return proposition over the medium term. A number of private equity transactions are in the pipeline from the Asia/Pacific region which will satisfy growing investor appetite for exposure to China, India and other Far Eastern countries.

As an unrated entity, the Bank is facing the challenge of raising unrestricted investment deposits, from both banks and customers, since counterparties prefer dealing with rated institutions whose exposures receive favourable capital treatment under the Basel II regime. Your Bank managed to overcome this challenge as evidenced by over BD96 million (US\$257 million) of outstanding interbank liabilities as of 31 December 2007. In a matured market like Bahrain, raising customer deposits is not easy either. However, the Bank has successfully overcome the funding challenges normally faced by any start-up entity by raising over BD132 million (US\$352 million) in customer deposits as of 31 December 2007.

Bahrain's banking sector has witnessed an unprecedented growth with total assets surpassing record levels reaching BD89.8 billion as of 30 November 2007. From a human capital perspective this situation has presented numerous challenges in recruitment. Your Bank has successfully overcome this challenge and recruited 33 qualified professionals with relevant skills during 2007 bringing the total workforce to 100 as of 31 December 2007. The challenge facing us is one of attracting additional resources and retaining the acquired talent and skills bank-wide. To overcome this challenge, the Bank commissioned the services of a leading international human resources consulting firm which devised the performance measurement and monitoring systems to reward employees based on their performance. The recommendations of the consulting firm are in the process of being implemented.

The Board is also pleased to note that your Bank is a member of the Central Bank of Bahrain's Real Time Gross Settlement (RTGS) system which enables the Bank to seek and offer interbank Bahrain dinar settlement within the same day of lodgement. The Bank has established a remote Disaster Recovery Site in Bahrain to ensure business continuity in the event of interruption to the main systems located in the headquarters site.

During 2007, to ensure operational efficiency going forward, the Bank focussed on streamlining various business and support processes to adhere to industry best practices and differentiate itself from competition. To name a few processes, Credit, Investment, Financial Planning, Budgeting & Forecasting, Management Information Systems, Recruitment and Training were streamlined in 2007.

The Directors are confident that your Bank is poised to outperform peers and in the medium term the Bank would move into a higher league

The Directors are confident that your Bank is poised to outperform peers and in the medium term the Bank should move into a higher league, i.e. from being part of a group of start-up banks to benchmarking itself with banks following a business model similar to that of your Bank and have been in existence for several years.

In the Extraordinary General Assembly Meeting held on 10 September 2007, the shareholders resolved to split the ordinary shares denominated at a par value of BD1 each into ten shares of 100 fils each and authorized the Board of Directors to seek cross listing of the Bank's stock on other stock exchanges. Following this, management completed the legal process of implementing the share split which became effective from 18 November 2007. Management is now looking at an opportune time to seek cross listing on other stock exchanges as resolved by the shareholders.

Financially, the year 2007 has seen impressive growth in net profit from BD16.4 million posted in 2006 to BD23.1 million in 2007, representing a return on equity of 17.0% (2006: 15.1%). The gross operating income amounted to BD33.9 million (2006: BD20.4 million) and the operating expenses were BD10.7 million (2006: BD4.0 million). The cost-to-income ratio for the year was 27.2% (2006: 19.6%) with the increase in costs attributable to the Bank becoming fully operational in 2007. The Earnings Per Share (EPS) for the year amounted to 19.3 fils (2006: 15.1 fils), adjusted for the share split that took place in 2007.

Retained Earnings and Appropriation of Net Income:

	BD'000
Balance at beginning of the year	3,333
Net profit for the year - 2007	23,149
Transfer to statutory reserve	(2,315)
Transfer to investment reserve	(11,079)
Zakah	(529)
Charitable contributions	(100)
Proposed dividends	(12,000)
Balance at end of the year	459

BOARD OF DIRECTORS'

REPORT TO THE SHAREHOLDERS (Continued)

Directors' and Senior Management Interests:

As required by the Central Bank of Bahrain rulebook set out below are the interests of Directors and Senior Managers in the shares of Al Salam Bank-Bahrain B.S.C. and the distribution of the shareholding as of 31 December 2007.

	31 December 2007
Directors' Shares	170,146,200
Senior Managers' shares	5,851,580
	175,997,780

Directors' remuneration, fees and expenses for attendance at Board meetings for 2007 amounted to BD 300,000.

	2007 No. of No. of Shares	No. of Shareholders	% of Total Outstanding shares
Percentage of shares held			
Less than 0.5%	627,236,606	22,657	52%
0.5% to less than 1%	225,376,341	27	19%
1% up to less than 5%	347,387,053	15	29%
TOTAL	1,200,000,000	22,699	100%

The Directors would like to express their appreciation to the leadership and ministries of the Kingdom of Bahrain, the Central Bank of Bahrain, correspondents, customers, shareholders and employees of the Bank for their support and collective contribution since the establishment of the Bank and look forward to their continued support in the fiscal year 2008.

Mohamed Ali Rashid Alabbar
Chairman

MESSAGE FROM THE CHIEF EXECUTIVE OFFICER



This year was the second financial year for the Bank since establishment. The Bank's strategic objectives for the year were defined in a three year strategic plan at inception of the Bank in 2006. The Board approved strategy focused mainly on the establishment of a strong organizational foundation to support consistent and sustainable growth. We have successfully achieved all our performance objectives for this year in addition to delivering excellent financial results for two years in a row as we continue to tap more opportunities for our customers and our shareholders.

Our excellent performance in the past two years since establishment is driven by our two core businesses, banking and investment, each of which made solid contributions. The overall performance achieved to date is an excellent proof of our ability to deliver in a competitive market within a short period of time.

On the other hand, as a newly established institution, the Bank faced a number of challenges since it's establishment. Nevertheless the Board of Directors and the Executive Management were successful in identifying, analyzing and managing these challenges to the benefit of all of the Bank's stakeholders.

In addition to the business establishment challenges, the Bank had to face the systemic effects of the sub-prime crisis, especially the challenges on liquidity management due to credit squeeze prompted by flight of capital to risk-free assets. However, looking back, we are proud to report that despite these challenges, the Bank managed to achieve excellent results as net operating income grew by 40.9%, total assets grew by 111.6% and inter-bank assets grew by 113.8%.

At year-end, our capital adequacy ratio was 48.7% compared to 79.8% at the end of the previous year with the significant reduction demonstrating the deployment of capital. Our capital adequacy ratio continued to remain significantly higher than the minimum ratio of 12% and 8% stipulated by the Central Bank of Bahrain and Basel Committee on Banking Supervision, respectively. This strong ratio provides more growth opportunities for the Bank while the 12% regulatory threshold offers a risk management buffer of 4% to cover unforeseen circumstances.

Social Contribution

The Bank allocated more than BD600,000 for Zakah and charity purposes and participated in a number of community sponsorship programs across Bahrain. The Bank is aware of its responsibilities in the communities where it operates and invests. To this end, the Bank established a Zakah and Charity Committee, a focused working group, to ensure that the Bank provides adequate support to social and community projects.

Yousif Abdulla Taqi
Chief Executive Officer

MANAGEMENT REVIEW OF OPERATIONS & ACTIVITIES

The Bank's strategy is built on providing investments, products and services that drive customer satisfaction and trust with the aim to increase our growing customer base.

Financial

Despite many challenges as a newly established institution, the Bank managed to achieve remarkable results by growing total operating income by 66.2% from BD20.4 million to BD33.9 million and net profit for the year by 40.9% from BD16.4 million to BD23.1 million. These results amount to a Return on Average Equity of 17.0% (15.1% in 2006) and Earnings Per Share of 19.3 fils (15.1 Fils in 2006).

The balance sheet strengthened further as total assets increased to BD397.8 million (US\$1,057.9 million) compared to BD188 million (US\$500 million) in 2006. While on the other hand, total equity increased to BD159.5 million (US\$424.2 million) compared to BD136.5 million (US\$363 million) in 2006.

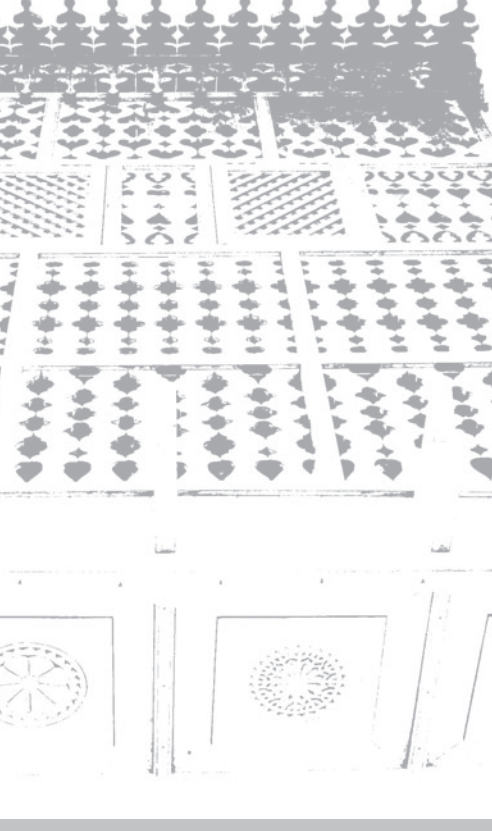
Organisational

The Bank continued to build and strengthen key business and support functions with the main objective of achieving higher levels of customer satisfaction across business lines. The focus during the year was to build efficient and effective turn-around processes for customer requests including commercial and retail banking financing requests, investment proposals and trust services opportunities. The processes established within the Bank are robust and no compromise is made against risk management or compliance as these are given utmost care and attention at all costs.

The Bank successfully completed the implementation of the state-of-the-art core banking system including the finalization of the internet banking platform. The targeted launch of the internet banking services in early 2008 will take the Bank to a higher league among its local and regional peers. Also, we are proud to become one of the first banks in the Kingdom of Bahrain to achieve full EMV "chip-card" compliance. This new technology offers better security for our customers when using their cards.

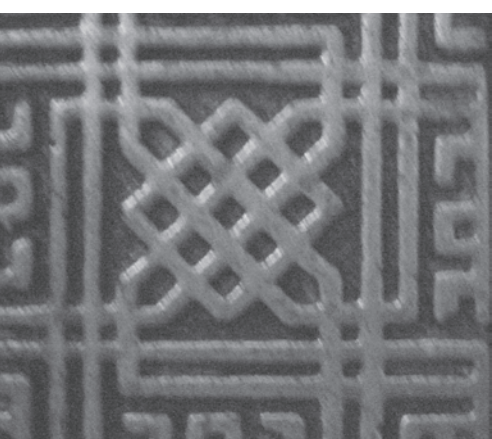
In addition, the Bank completed the implementation of the HR Management System including the interface of the system with the core banking application. Furthermore, the Bank has started the implementation of a Document Management System towards the end of the year to ensure efficient management of customers' and Bank data.

During the year, the Bank recruited more than 30 skilled and experienced staff across different areas of specialization. These additional resources enhanced the Bank's capabilities to efficiently and effectively deliver new products and services to our customers in line with our business strategy. The number of staff at end of the financial year was 100 compared to 70 on 31 December 2006.



We take training of our staff seriously and from the moment they join our Bank all staff are subject to different forms of training from on-the-job training to in-house classroom training to regional and overseas training courses and workshops. During the past financial year, the staff received about 2,000 hours of internal and external training. Each and every staff member undergoes training needs analysis which is followed by a training program under the supervision of the Human Resources Department.

In addition, all staff attended a number of internal training programs covering Anti-money Laundering Policies and Procedures, Corporate Governance, Risk Management and Basel II.



Banking

As a core business division of the Bank, the Banking Group is responsible for Retail Banking, Corporate Banking, Private Banking and Wealth Management. The Group is also responsible for placement of investment products to private banking and wealth management clients.

The Group aspires to provide innovative banking solutions to its clients whether corporate or individuals, rather than merely providing financing to them. The main objective of the Group is to understand the needs and requirements of its customers and ensure that these are met. The Group's approach is consistent with the Bank's overall strategy as a partner to its clients rather than a financier in line with the principles of Shari'a compliant banking.

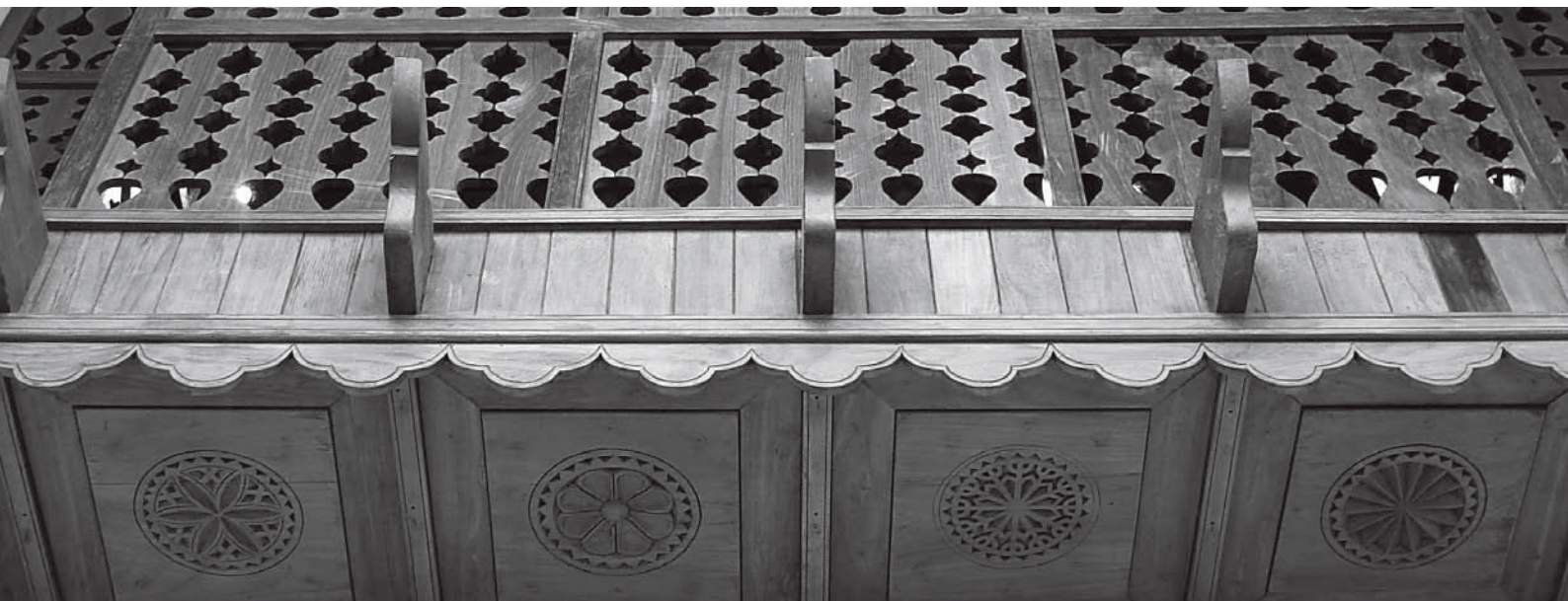
Overall, corporate and retail banking performed well. Significant growth was achieved in volumes and number of customers without sacrificing on asset quality. The Bank ended the financial year with zero non-performing relationships.

During the past year the Bank scored a number of wins on competitive bidding transactions, by securing three competitive bids to finance in aggregate of BD62.4 million (US\$166 million) to the Government of Bahrain and its entities.

On the retail and private banking front, the Bank commenced retail operations after the successful launch of the retail operations in May 2007. With the launch, the Bank opened its first branch at Al Seef District followed by the soft launch of the internet banking services. Since then, the Bank has been consistently growing its customer base as it launches new products and services. One of the key banking products launched in the past year was Al Salam Wakala Deposit, which continues to offer competitive returns for its customers.

The launch of the private and retail banking investment products including the new Wakala Deposit and the winning of the three government financing bids within a short period of time since establishment has strengthened the Bank's competitive position in the market.

MANAGEMENT REVIEW OF OPERATIONS & ACTIVITIES (Continued)



Investments

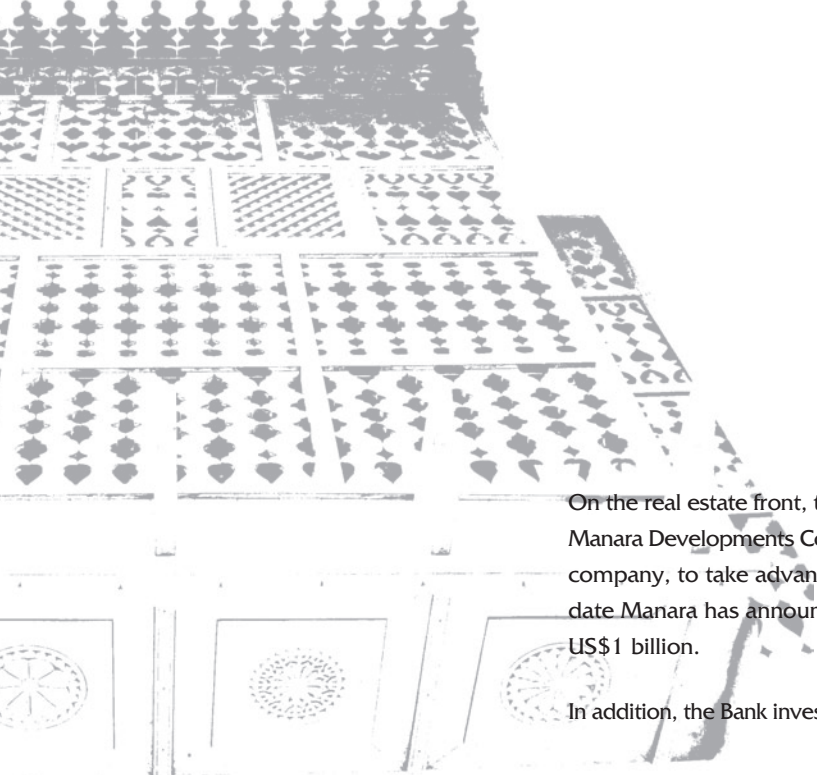
As the second core business division of the Bank, the Investment Group is responsible for managing the Bank's corporate and real estate investment activities. The Group focuses on key sectors through which the Bank can meet the expectations and demands of its clients.

The Group is structured into two specialist units: Corporate Investments and Real Estate Investments. The Corporate Investments Unit focuses primarily on sourcing, acquiring, managing and exiting private equity deals. The Unit focuses on identifying opportunities in the MENA region, Asia Pacific and Europe covering alternative energy, aviation and health care sectors.

During the year the Group closed a US\$34 million aviation transaction through the acquisition of a 1999 built Boeing 777-200ER aircraft on lease to a government owned entity, Malaysian Airline Systems Berhad.

To take advantage of the opportunities in Asia, the Bank successfully concluded an 80% participation in a private equity fund for US\$50 million with underlying being significant minority stake in Chinese manufacturing, food and consumer goods industries.

The Group also identified an opportunity in alternative energy where the Bank acquired rights to construct, commission and operate a 100,000 MT biodiesel plant in Hong Kong. The technology in use is unique in that the plant uses non-food raw materials such as waste cooking oil, grease trap waste, non-pork animal fat and palm oil fatty acid distillate which are converted into Biodiesel. The Biodiesel plant will be strategically located in a science and technology park in Hong Kong.



On the real estate front, the Bank in partnership with strategic investors established Manara Developments Company B.S.C.(c), a Bahrain-based real estate development company, to take advantage of the real estate opportunities in the country. To date Manara has announced development projects in the pipeline in excess of US\$1 billion.

In addition, the Bank invested in a grand scale investment project in Penang, Malaysia.

Treasury & Financial Markets

The Treasury and Financial Markets Group focuses on providing treasury related services such as foreign exchange, liquidity management, Sukuk trading and structuring and distribution of structured products. The team achieved excellent growth in inter-bank assets, efficiently supported liquidity management, developed new key alliances with local, regional and international financial institutions, generated positive contribution to the bottom line, recruited qualified treasury personnel and established a modern treasury dealing room with all the necessary tools and equipment.

Risk Management & Compliance

The Risk Management & Compliance Group operates as an independent function from business lines with a direct reporting line to the Chief Executive Officer. The Risk Management Group Head is the Chairman of the Risk/Credit Committee and a member of the Asset Liability Management Committee and Investment Committee.

All proposals for financing or investment are routed to the relevant committee for approval after detailed review and analysis by the Risk Management & Compliance Group.

The Bank invested a considerable amount of human and financial resources towards meeting the Basel II implementation deadline of 2008 as set out by the Central Bank of Bahrain. The Bank views the implementation of and compliance with the Basel II Accord as a strategic element of our business model as it will facilitate the strengthening of our risk management framework and better alignment of risk and rewards leading to efficient utilization of capital.

The Risk Management and Compliance Group finalized the development of the Basel II implementation plan, developed all its major risk policies in line with Basel II framework, provided Basel II and risk management training to all relevant staff across business and support functions, assessed and short-listed potential vendors for Basel II and risk systems and finalized the development of the Internal Capital Adequacy Assessment Framework (ICAAF).

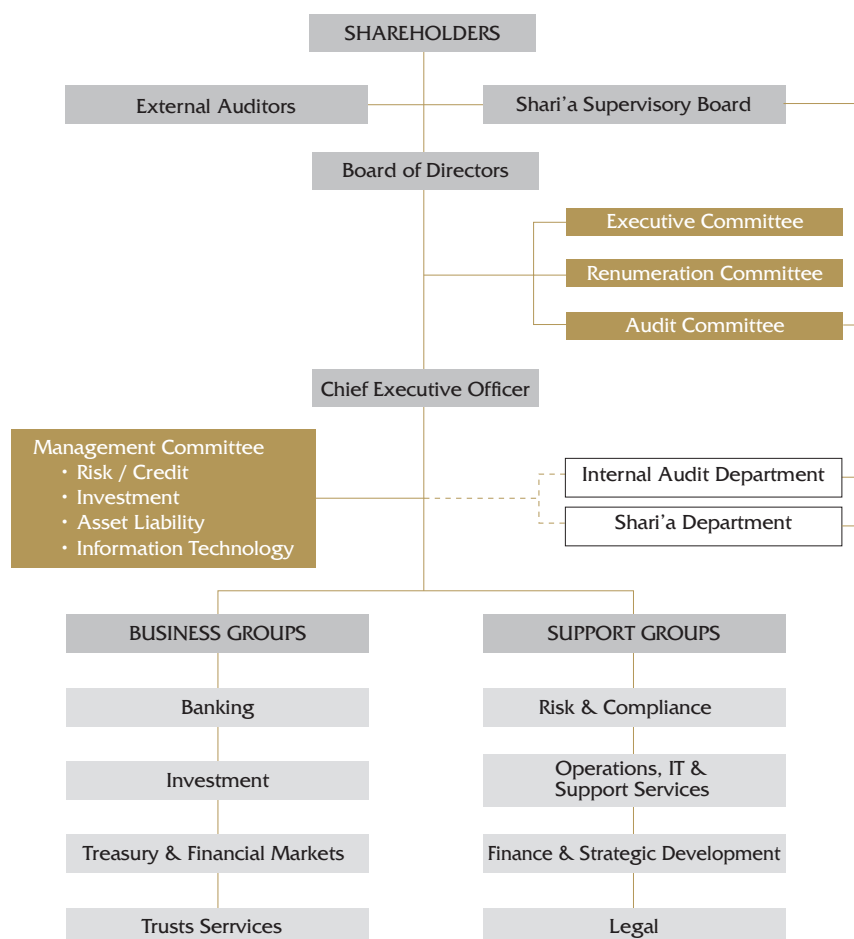
The Compliance function under this group ensured that the Bank has adequate compliance policies and procedures, all relevant staff received appropriate compliance and anti-money laundering training, timely periodic reporting to the Board and Executive Management and successful resolution of any significant matters related to compliance.

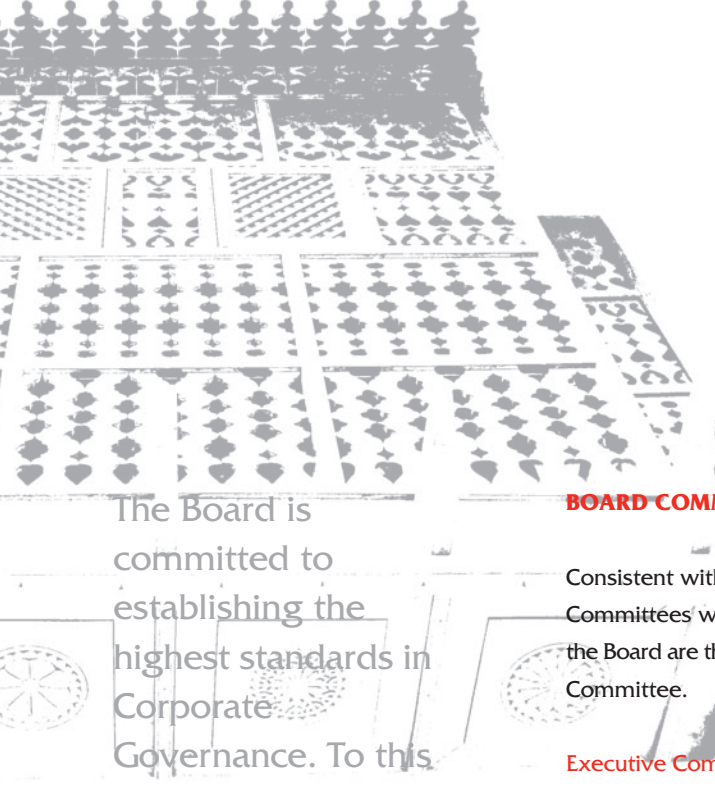
CORPORATE GOVERNANCE

The Board is committed to establishing the highest standards in Corporate Governance. To this end, it has established various committees in line with industry best practice and has also directed the Senior Management to establish various management committees with relevant members. The Board Charter imposes the highest level of ethical conduct; doing what it proclaims to be its responsibility; reporting results with accuracy and transparency in a timely manner; and ensuring full compliance with the by-laws, and the rules and regulations that govern the Bank's business. The Board has adopted a Board Charter, which together with the Bank's Memorandum and Articles of Association and the Charters of various Board Committees, provides the authority and practices for governance of the Bank.

The Board provides central leadership to the Bank. It has established and defined the objectives and strategies that direct the ongoing activities of the Bank to enable it to achieve its objectives. The roles and responsibilities of the Board of Directors, their independence, code of conduct and ethics are described in the Board Charter.

The Bank is organized as follows:





The Board is committed to establishing the highest standards in Corporate Governance. To this end, it has established various committees in line with industry best practice and has also directed the Senior Management to establish various management committees with relevant members.

BOARD COMMITTEES

Consistent with the industry's best practice, the Board has established three Committees with defined roles and responsibilities. The Standing Committees of the Board are the Executive Committee, the Audit Committee, and the Remuneration Committee.

Executive Committee

Has delegated authority within the overall Board authority. Provides direction to the executive management on all business matters and assumes the role of the Board to address matters arising between Board meetings. The Committee is responsible for business matters concerning credit and market risks, strategy review and recommendation to the Board.

Audit Committee

Has responsibility to assist the Board in discharging its oversight duties relating to matters such as risk and compliance, including the integrity of the Bank's financial statements, financial reporting process and systems, internal controls and financial controls. The Committee also, acts as a liaison between the External auditors and the Board and between the Regulators and the Board.

Remuneration Committee

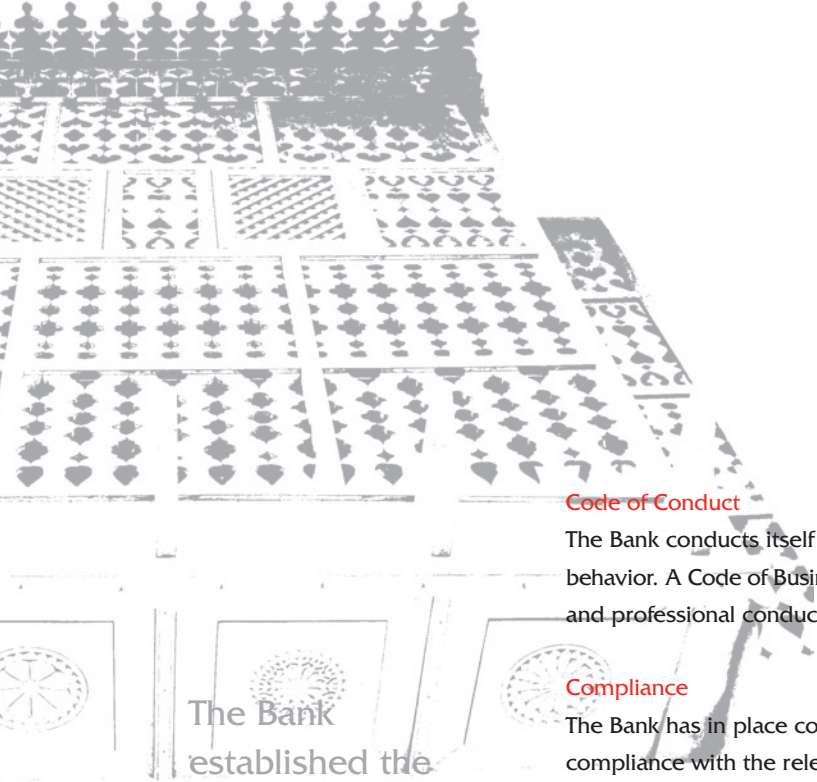
The role is to provide a formal and transparent procedure for developing a compensation policy for the Chief Executive Officer and senior management; ensures that compensation offered is competitive, in line with the market/peer group and consistent with the responsibilities assigned to employees. The Committee approves policies covering hiring, compensation and training. In addition, the Committee recommends to the Board special compensation plans, including annual performance bonus and short/long term incentives, to attract, motivate and retain key employees.

CORPORATE GOVERNANCE (Continued)

MANAGEMENT COMMITTEES

The Chief Executive Officer is supported by a number of management committees each having a specific mandate to give focus to areas of business, risk and strategy. The various committees and their roles and responsibilities are:

Committee	Roles and responsibilities
Credit/Risk Committee	Recommending the risk policy and framework to the Board. Its Primary role is the selection and implementation of risk management systems, portfolio monitoring, stress testing, risk reporting to Board, Board Committees, Regulators and Executive Management. In addition to these responsibilities, individual credit transaction approval and monitoring is an integral part of the responsibilities.
Asset Liability Committee	This Committee's primary responsibility is to review the trading and liquidity policy for the overall management of the balance sheet and its associated risks.
Investment Committee	The role of the Committee is to review and approve all transactions related to corporate and real estate investments and monitoring their performance on an ongoing basis. In addition, the Committee is responsible to oversee the performance of the fund managers and recommend exit strategies to maximize return to its investors.
Technology Steering Committee	TSC oversees the information technology function of the Bank. It recommends the annual IT budget and plans, drawn up in accordance with the approved strategy for the Bank, to the CEO for submission to the Board of Directors for their approval. It supervises the implementation of the approved IT annual plan within set deadlines and budgetary allocations.



The Bank established the Investor Relations Unit as a step to enhancing the communication with its shareholders.

Code of Conduct

The Bank conducts itself in accordance with the highest standards of ethical behavior. A Code of Business Conduct has been developed to govern the personal and professional conduct of all stakeholders.

Compliance

The Bank has in place comprehensive policies and procedures to ensure full compliance with the relevant rules and regulations of the Central Bank of Bahrain and the Bahrain Stock Exchange, including anti-money laundering, prudential and insider trading reporting.

Communications

The Bank conducts all communications with its stakeholders in a professional, honest, transparent, understandable, accurate and timely manner. Main communications channels include annual reports, corporate brochure and website, and regular announcements in the appropriate local media and the internet.



RISK MANAGEMENT AND COMPLIANCE

At Al Salam Bank - Bahrain we appreciate the fact that we are in the business of taking risks and our success is largely dependent on how efficiently we identify, measure, control and manage these risks. Hence, we view risk management as a core competency from a strategic point of view and the Basel II Accord as a catalyst to the successful implementation of the pillars of risk management.

The fundamental principle underlying our risk management framework is ensuring that accepted risks are within Board approved risk appetite and the returns are commensurate with the risks taken. The objective is creating shareholder value through protecting the Bank against unforeseen losses, ensuring maximization of earnings potential and opportunities vis-à-vis the Bank's risk appetite and ensuring earnings stability.

With this in mind, the Bank's establishment plan gave priority to the development of an effective and practical risk management framework and independent risk management and compliance function in line with best risk management practice locally and internationally, the requirements of Central Bank of Bahrain and the Basel II Accord.

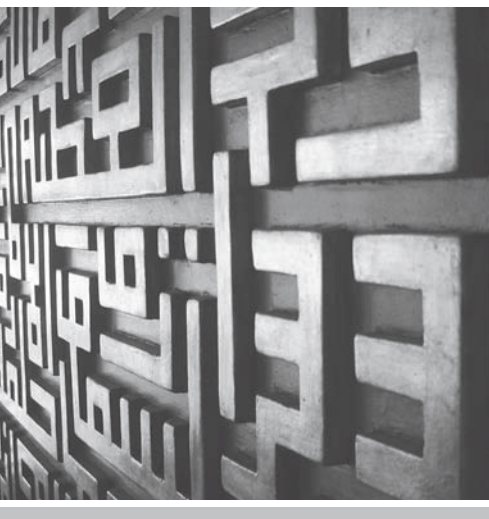
RISK MANAGEMENT FRAMEWORK

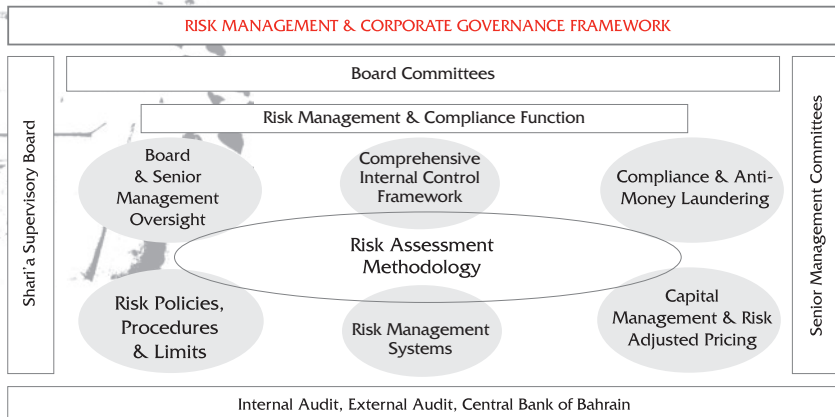
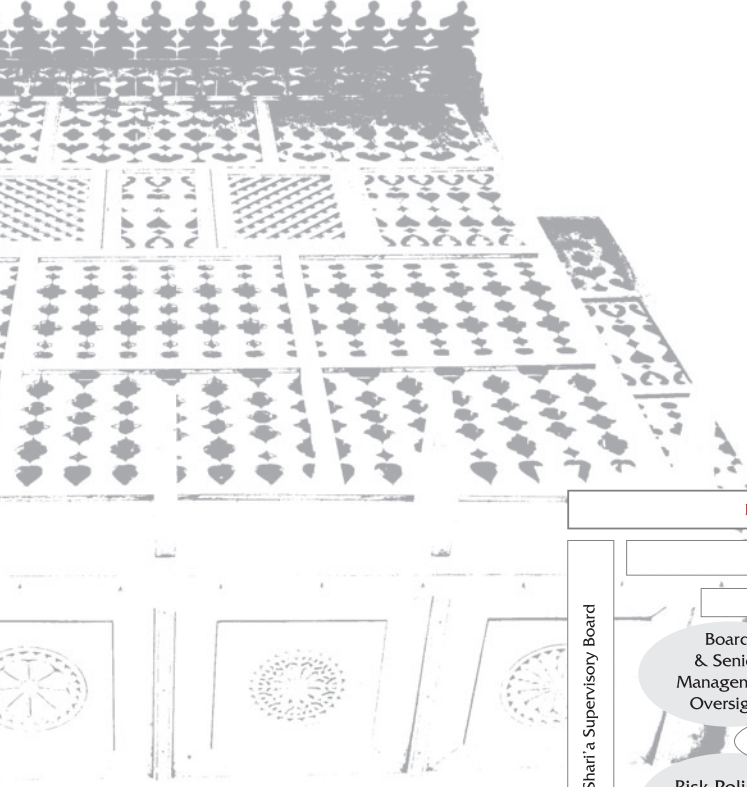
The risk management framework defines the risk culture of Al Salam Bank - Bahrain and sets the tone throughout the Bank to practice the right risk behavior consistently to ensure that there is always a balance between business profits and risk appetite.

The risk management framework achieves this through the definition of the Bank's key risk management principles covering credit, market, operational, strategic and reputation risks, the role and responsibilities of the Board, Risk Management group and Senior Management towards risk management, the risk assessment methodology based on likelihood and consequences, the major risk policies, procedures and risk limits, the risk management information systems and reports, the internal control framework and the Bank's approach to capital management.

The effectiveness of the risk management framework is independently assessed and reviewed through Internal audits, External audits and Central Bank of Bahrain supervision. In addition, business and support groups carry out periodic control risk self assessments.

As a result, the risk management framework creates an alignment between business and risk management objectives.





CAPITAL MANAGEMENT

The cornerstone of risk management framework is the optimization of risk-reward relationship against the capital available through a focused and well monitored capital management process involving Risk Management, Finance and Business groups.

CORPORATE GOVERNANCE

The risk management framework is supported by an efficient Corporate Governance Framework discussed on pages 26 to 29.

RISKS OWNERSHIP

The implementation of the risk management framework bank-wide is the responsibility of the Risk Management & Compliance Group. Ownership of the various risks across the Bank lies with the business and support Heads and it is their responsibility to ensure that these risks are managed in accordance with the risk management framework. Risk Management will assist business and support heads in identifying concerns and risks, identifying risk owners, evaluating risks as to likelihood and consequences, assessing options for accommodating the risks, prioritizing risk management efforts, developing risk management plans, authorizing implementation of risk management plans and tracking risk management efforts.

RISK MANAGEMENT AND COMPLIANCE ORGANIZATION

Al Salam Bank- Bahrain Risk Management and Compliance Group function is headed by an independent Chief Risk Officer with direct reporting line to the Chief Executive Officer.

Board Approved Policies, Procedures and Limits				
Credit Risk Management	Market Risk Management	Operational Risk Management	Capital Management	Compliance & Anti Money Laundering
<ul style="list-style-type: none"> Exposures and limits Monitoring Portfolio Management Timely Reporting to Credit Committee Internal Rating Methodology Periodic Stress Testing and Scenario Analysis 	<ul style="list-style-type: none"> Positions and Limits Monitoring Risk Measurement Methodology Timely reporting to ALCO 	<ul style="list-style-type: none"> Control Self Assessments Key Risk Indicators Monitoring Risk & Loss Events Database IT Security Management Business Continuity Planning Outsourcing Risk Management 	<ul style="list-style-type: none"> Basel II Compliance Risk Adjusted Pricing Reporting to Board Executive Committee Scenario Analysis 	<ul style="list-style-type: none"> Compliance Monitoring Anti-money Laundering control Training and Awareness Systems Controls

RISK MANAGEMENT AND COMPLIANCE (Continued)

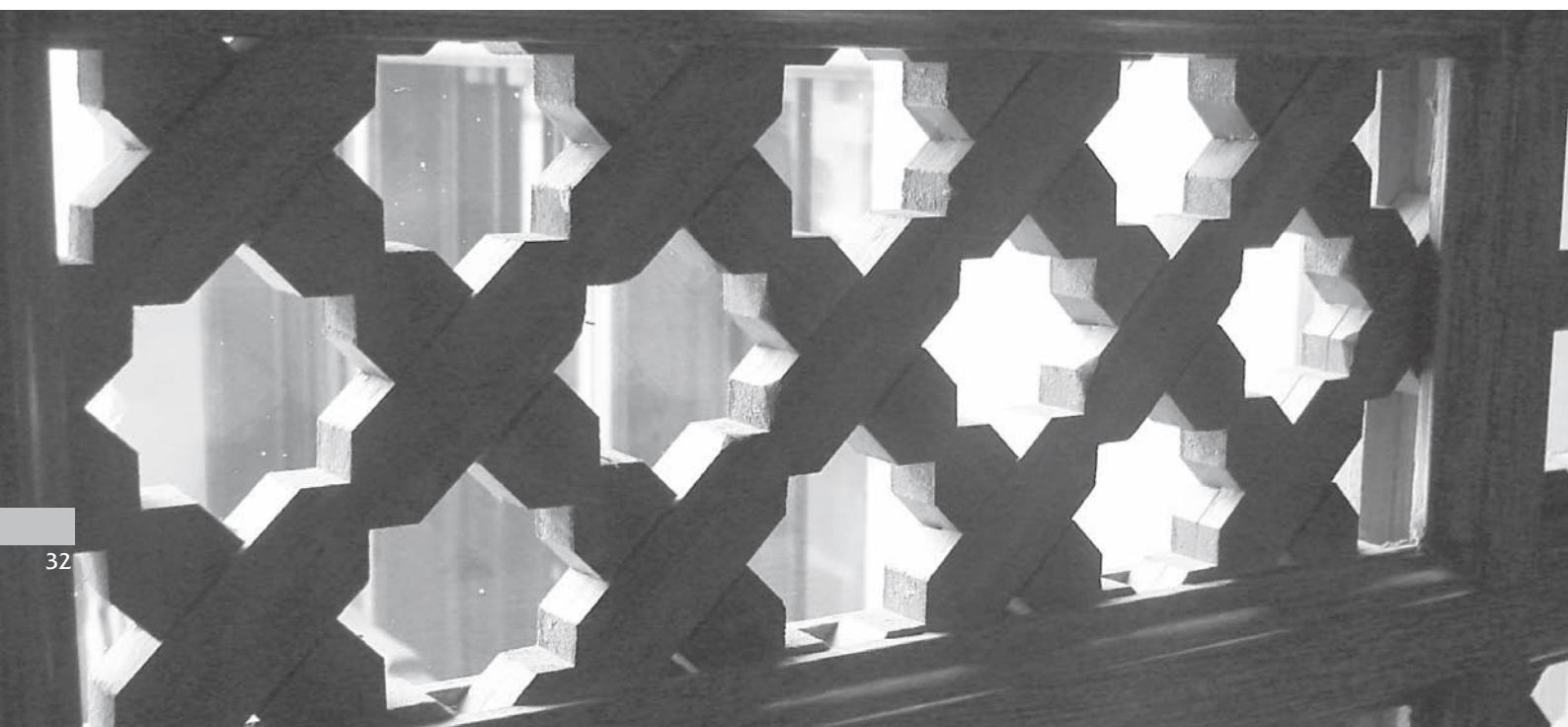
COMPLIANCE & ANTI-MONEY LAUNDERING UNIT

The Bank has established an independent and focused unit to coordinate the implementation of compliance and Anti-Money Laundering and Anti-Terrorist Financing program. The program covers policies and procedures for managing compliance with regulations, anti-money laundering, disclosure standards on material and sensitive information and insider trading.

In line with its commitment to combat money laundering and terrorist financing, Al Salam Bank - Bahrain through its Anti-Money Laundering policies ensures that adequate preventive and detective internal controls and systems operate effectively. The policies govern the guidelines and procedures for client acceptance, maintenance and monitoring in line with the Central Bank of Bahrain and International standards such as FATF 40 + 9 recommendations and Basel Committee papers.

All inward and outward electronic transfers are screened against identified sanction lists issued by certain regulatory bodies including the UN Security Council Sanctions Committees and US Department of the Treasury - OFAC, in addition to those designated by the Central Bank of Bahrain.

The compliance program also ensures that all applicable Central Bank of Bahrain regulations are complied with and/or non-compliance is detected and addressed in a timely manner. The program includes compliance with regulations set by Ministry of Industry & Commerce and Bahrain Stock Exchange.



CORPORATE SOCIAL RESPONSIBILITY



**Bahrainis
accounted
for 87% of all
employees
at the end
of 2007.**

Since its inception, social responsibility formed a priority for Al Salam Bank–Bahrain. The Bank adopts a very balanced policy to contribute to the social and economic well-being of the communities in which it operates. The Bank focused on several educational initiatives such as the donation towards the Crown Prince International Scholarship Program.

The Bank had several effective sponsorships and participations in local and international conferences and events such as the “EnviroArabia 2007”, the sponsorship of the showcase reception held during the IMF & World Bank meeting in Washington, which was an opportunity for the Bank to promote its investments opportunities and solutions and promote Bahrain as a regional investment hub. The Bank also sponsored the Second Arab Kids Forum, which looked into inspiring and empowering of the youth capability that could be a start for the leaders of the future.

The Bank adopts a policy that supports training and employment. Bahrainis accounted for 87 per cent of all employees at the end of 2007. Also in 2007 the Bank received the first batch of university students as part of its Summer Training Program. The students occupied positions to gain work experience relevant to their studies.

During the year, the Bank has allocated part of its profit to aid society and enhance the quality of life for everyone, through its support for charitable, educational, medical, scientific, cultural, social, sporting and environmental organisations.



FINANCIAL STATEMENTS

Net profit of BD23.1 million (US\$61.4 million) for 2007 showing an increase of 41% over 2006.

THE SHARI'A SUPERVISORY BOARD REPORT TO THE SHAREHOLDERS

FOR THE YEAR ENDED 31 DECEMBER 2007

In the name of Allah, The Beneficent, The Merciful, Praise be to Allah, the Lord of the worlds, and blessing and peace be upon His Prophet Mohammed and the people of His house and His companions.

Firstly:

The Shari'a Supervisory Board ("the Board") of Al Salam Bank-Bahrain B.S.C. ("the Bank") supervised the Bank's activities and transactions carried out during the year 2007. The Board carried out its role by guiding the various departments to comply with the principles of Islamic Shari'a and with specific Fatwas. The Board has conducted various meetings with the Bank's Management and acknowledged that they have been complying with the principles of Islamic Shari'a and the Board's Fatwas.

The Board has studied the transactions submitted by the Bank during the year, approved its contracts, and responded to related questions and queries. The Board issued suitable decisions and Fatwas to the Bank for execution.

Secondly:

The Board has reviewed the contracts and agreement templates and requested management adherence to those templates. Furthermore, the Board has resolved to schedule a training plan for the employees on the new Shari'a agreements for immediate implementation.

Thirdly:

The Board has reviewed the financial statements and the related notes and disclosures. The Board believes that:

1. These financial statements fairly represent the Bank's assets and revenues.
2. The Bank maintains three separate pools i.e. one each for Wakala deposits, Mudaraba deposits, and shareholders equity. It is the Board's opinion that the balance sheet and income statement as well as the distribution of profits to the depositors and shareholders are presented accordingly.

Fourthly:

The Board noted that the Bank's Articles of Association have been amended to enable the Bank to pay Zakah out of the shareholders' equity, and the Board approves the Zakah payable calculation prepared by management.

Based on the internal Shari'a audit reports, reviewed transactions and recommendations implemented by management, the Board confirms that the Bank's transactions executed during the year do not violate Islamic Shari'a principles.



Dr. Hussain Hamid Hassan
Chairman



Shaikh Adnan Abdulla Al Qattan
Member



Dr. Ali Mohiuddin Al Qurra Daghi
Member



Dr. Mohamed Abdul Hakim Zoeir
Member & Board Secretary

We have audited the accompanying financial statements of Al-Salam Bank Bahrain B.S.C. (“the Bank”), which comprise the balance sheet as at 31 December 2007 and the statement of income, statement of changes in equity and cash flow statement for the year ended 31 December 2007, and a summary of significant accounting policies and other explanatory notes.

Board of Director’s Responsibility for the Financial Statements

The Board of Directors are responsible for the preparation and fair presentation of these financial statements in accordance with Financial Accounting Standards issued by Accounting and Auditing Organization for Islamic Financial Institutions, to operate in accordance with Islamic Shari’a. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In addition the Board of Directors are responsible for the Bank’s undertaking to operate in accordance with Islamic Shari’a Rules and Principles.

Auditors’ Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing and Auditing Standards issued by Accounting and Auditing Organization for Islamic Financial Institutions. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2007 and of its financial performance and its cash flows for the year ended 31 December 2007 in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions and the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

Other Regulatory Matters

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the financial statements, and the contents of the Report of the Board of Directors relating to these financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank have occurred during the year ended 31 December 2007 that might have had a material adverse effect on the business of the Bank or on its financial position, and that the Bank has complied with the terms of its banking licence.

A handwritten signature in black ink that reads 'Ernst & Young'.

4 February 2008

Manama, Kingdom of Bahrain

BALANCE SHEET

31 December 2007

	Notes	31 December 2007 BD	31 December 2006 BD
ASSETS			
Cash and balances with Central Bank of Bahrain	4	15,173,663	2,942,042
Central Bank of Bahrain Sukuk		20,380,000	-
Murabaha and Mudaraba with banks	5	224,450,893	105,089,786
Murabaha financing	6	32,641,599	22,963,267
Ijarah Muntahia Bittamleek	6 & 7	10,435,863	10,382,429
Non-trading investments	8	62,735,696	32,618,646
Investment in an associate	9	8,272,000	2,073,500
Investment properties		1,177,528	1,177,528
Receivables and prepayments	10	10,505,046	8,784,454
Premises and equipment		2,979,252	2,026,884
Investments held-for-sale		9,024,000	-
TOTAL ASSETS		397,775,540	188,058,536
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY			
LIABILITIES			
Murabaha from banks		96,983,041	23,647,305
Murabaha from non-banks		106,908,709	20,111,967
Customers' current accounts		5,688,686	5,673,812
Other liabilities	11	8,954,642	2,223,863
		218,535,078	51,656,947
UNRESTRICTED INVESTMENT ACCOUNTS	12	19,769,585	-
EQUITY			
Share capital	13	120,000,000	120,000,000
Treasury stock	13	-	(17,203)
Reserves and retained earnings	14 & 15	38,941,790	16,418,792
Proposed appropriations	32	529,087	-
		159,470,877	136,401,589
TOTAL LIABILITIES, UNRESTRICTED INVESTMENTS ACCOUNTS AND EQUITY		397,775,540	188,058,536

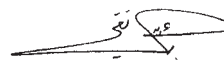
The financial statements have been authorised for issue in accordance with a resolution of the Board of Directors on 4 February, 2008.



Mohamed Ali Rashid Alabbar
Chairman



Hussein Mohammed Al Meeza
Vice Chairman



Yousif Taqi
Chief Executive Officer

The attached notes 1 to 34 form part of these financial statements.

STATEMENT OF INCOME

Year ended 31 December 2007

	31 December 2007 BD	19 January 2006 to 31 December 2006 BD
OPERATING INCOME		
Income from Murabaha and Mudaraba	8,239,228	8,501,816
Income from other Islamic financing contracts	4,330,891	643,221
	12,570,119	9,145,037
Profit paid on Murabaha from banks	(2,815,106)	(42,368)
Profit paid on Murabaha from non-banks	(2,704,532)	(387,697)
Share of profit to unrestricted investment account holders	(245,414)	–
	6,805,067	8,714,972
Fees and commission income (note 16)	4,480,641	254,381
Gain on sale of investments designated as held-for-sale	11,017,492	
Unrealised gains on investments designated as fair value through profit or loss	11,079,352	11,443,688
Foreign exchange gains	254,264	15,792
Other operating income	215,703	–
TOTAL OPERATING INCOME	33,852,519	20,428,833
OPERATING EXPENSES		
Staff costs	5,312,083	2,393,760
Premises and equipment cost	423,905	219,525
Depreciation	745,138	54,633
Depreciation on Ijarah Muntahia Bittamleek	1,140,346	–
Other operating expenses	2,981,195	1,342,123
TOTAL OPERATING EXPENSES	10,602,667	4,010,041
OPERATING PROFIT	23,249,852	16,418,792
Share of loss of associate	100,858	–
PROFIT FOR THE YEAR	23,148,994	16,418,792
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING (NOTE 13)	1,199,935,900	1,089,777,780
BASIC EARNINGS PER SHARE (FILS)	19.3	15.1

The attached notes 1 to 34 form part of these financial statements.

STATEMENT OF CASH FLOWS

Year ended 31 December 2007

	31 December 2007 BD	19 January 2006 to 31 December 2006 BD
OPERATING ACTIVITIES		
Profit for the year	23,148,994	16,418,792
Adjustments:		
Depreciation	745,138	54,633
Changes in fair value of investments carried at fair value through profit or loss	(11,079,352)	(11,443,688)
Operating income before changes in operating assets and liabilities	12,814,780	5,029,737
Changes in operating assets and liabilities:		
Mandatory reserve with Central Bank of Bahrain	(4,710,000)	(930,000)
Central Bank of Bahrain Sukuk	(20,380,000)	–
Murabaha and Mudaraba with Banks with original maturities of 90 days or more	14,439,734	(14,816,100)
Murabaha financing	(9,678,332)	(22,963,267)
Ijarah Muntahia Bittamleek	(53,434)	(10,382,429)
Receivables and prepayments	(1,720,592)	(8,784,454)
Customers' current accounts	14,874	5,673,812
Murabaha from banks	73,335,736	23,647,305
Murabaha from non-banks	86,796,742	20,111,967
Other liabilities	6,630,779	1,935,676
Net cash from (used in) operating activities	157,490,287	(1,477,753)
INVESTING ACTIVITIES		
Purchase of investments held-for-sale	(17,845,885)	–
Proceeds from sale of investments held-for-sale	8,821,885	–
Investment in an associate	(6,198,500)	(2,073,500)
Premises and equipment	(1,697,506)	(2,081,517)
Investment properties	–	(1,177,528)
Non-trading investments	(19,037,698)	(20,886,771)
Net cash used in investing activities	(35,957,704)	(26,219,316)

STATEMENT OF CASH FLOWS

Year ended 31 December 2007

	31 December 2007 BD	19 January 2006 to 31 December 2006 BD
FINANCING ACTIVITIES		
Issue of equity shares, net of treasury stock	–	119,982,797
Proceeds from sale of treasury stock	20,294	–
Unrestricted investment accounts	19,769,585	–
	<hr/>	<hr/>
Net cash from financing activities	19,789,879	119,982,797
	<hr/>	<hr/>
NET INCREASE IN CASH AND CASH EQUIVALENTS	141,322,462	92,285,728
	<hr/>	<hr/>
Cash and cash equivalents at 1 January	92,285,728	–
	<hr/>	<hr/>
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	233,608,190	92,285,728
	<hr/>	<hr/>
Cash and cash equivalents comprise of:		
Cash and other balances with Central Bank of Bahrain	1,814,814	505,920
Balances with other banks	7,718,849	1,506,122
Murabaha and Mudaraba with banks with original maturities of less than 90 days	224,074,527	90,273,686
	<hr/>	<hr/>
	233,608,190	92,285,728
	<hr/>	<hr/>

STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2007

	Share capital BD	Treasury stock BD	Statutory reserve BD	Retained earnings BD	Investment reserve BD	Proposed appropria- -tions BD	Total equity BD
Balance as of 1 January 2007	120,000,000	(17,203)	1,641,879	3,333,225	11,443,688	-	136,401,589
Zakah	-	-	-	(529,087)	-	529,087	-
Charitable donations	-	-	-	(100,000)	-	-	(100,000)
Net profit for the year	-	-	-	23,148,994	-	-	23,148,994
Transfer to statutory reserve	-	-	2,314,899	(2,314,899)	-	-	-
Sale of treasury stock	-	17,203	3,091	-	-	-	20,294
Transfers	-	-	-	(11,079,352)	11,079,352	-	-
Balance at 31 December 2007	120,000,000	-	3,959,869	12,458,881	22,523,040	529,087	159,470,877
Proceeds from issue of share capital	120,000,000	(17,203)	-	-	-	-	119,982,797
Net profit for the period	-	-	-	16,418,792	-	-	16,418,792
Transfer to statutory reserve	-	-	1,641,879	(1,641,879)	-	-	-
Transfers	-	-	-	(11,443,688)	11,443,688	-	-
Balance at 31 December 2006	120,000,000	(17,203)	1,641,879	3,333,225	11,443,688	-	136,401,589

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

1 INCORPORATION AND PRINCIPAL ACTIVITIES

a) **Incorporation**

Al Salam Bank-Bahrain B.S.C. ("the Bank") was incorporated in the Kingdom of Bahrain under the Bahrain Commercial Companies Law No. 21/2001 and was registered with Ministry of Industry and Commerce under Commercial Registration Number 59308 on 19 January 2006. The Bank is regulated and supervised by the Central Bank of Bahrain (CBB) and has a retail Islamic banking licence and is operating under Islamic principles, and in accordance with all the relevant regulatory guidelines for Islamic banks issued by the CBB. The Bank's registered office is P.O. Box 18282, Building 22, Avenue 58, Block 436, Al Seef District, Kingdom of Bahrain.

b) **Principal activities**

The Bank offers a full range of Shari'a-compliant banking services and products. The activities of the Bank include accepting money placements/deposits, managing profit sharing investment accounts, offering Islamic financing contracts, dealing in Shari'a-compliant financial instruments as principal/agent, managing Shari'a-compliant financial instruments and other activities permitted for under the CBB's Regulated Banking Services as defined in the licensing framework.

2 ACCOUNTING POLICIES

2.1 **BASIS OF PREPARATION**

The financial statements are prepared on a historical cost basis, except for investments held at fair value through profit or loss and investment properties that have been measured at fair value.

These financial statements are presented in Bahraini dinars, being the functional currency of the Bank.

Statement of compliance

The financial statements of the Bank are prepared in accordance with the Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law. In accordance with AAOIFI, for matters for which no AAOIFI standards exist, the Bank uses the relevant International Financial Reporting Standard.

2.2 **SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES**

The preparation of the financial statements requires management to make judgements and estimates that affect the reported amount of financial assets and liabilities and disclosure of contingent liabilities. These judgements and estimates also affect the revenues and expenses and the resultant provisions as well as fair value changes reported in equity.

Judgements are made in the classification of available-for-sale, fair value through profit or loss or held-to-maturity investments based on management's intention at acquisition of the financial asset. As fully described below, judgements are also made in determination of the objective evidence that a financial asset is impaired.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

2 ACCOUNTING POLICIES (Continued)

2.2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (Continued)

Classification of investments

Management decides upon acquisition of an investment whether it should be classified as fair value through profit or loss, available for sale or held-to-maturity.

Impairment of available-for-sale equity investments

The Bank treats available-for-sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. In addition, the Bank evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimating uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment losses on financial contracts

The Bank reviews its problem financial contracts on a regular basis to assess whether a provision for impairment should be recorded in the statement of income. 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. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

Collective impairment provisions on financial contracts

In addition to specific provisions against individually significant financial contracts the Bank also considers the need for a collective impairment provision against financial contracts which although not specifically identified as requiring a specific provision have a greater risk of default than when originally granted. This collective provision is based on any deterioration in the status, as determined by the Bank, of the financial contract since it was granted (acquired). The amount of the provision is based on the historical loss pattern for other contracts within each grade and is adjusted to reflect current economic changes.

Valuation of unquoted equity investments

Valuation of unquoted equity investments is normally based on one of the following:

- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same;
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics; or
- other valuation models.

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

The Bank calibrates the valuation techniques periodically and tests these for validity using either prices from observable current market transactions in the same instrument or other available observable market data.

The principal accounting policies applied in the preparation of these financial statements are set out below:

Financial contracts

Financial contracts consist of cash and balances with banks and the Central Bank of Bahrain, Murabaha receivables (net of deferred profit), Mudaraba and Ijarah Muntahia Bittamleek. Balances relating to these contracts are stated net of provisions for impairment.

Murabaha receivables

Murabaha receivables are stated net of provision for impairment and deferred profits.

Ijarah Muntahia Bittamleek

Ijarah Muntahia Bittamleek assets comprises assets under lease, comprising aircraft, land and buildings, under terms that would transfer ownership of the assets to third parties at the end of the respective lease period.

Depreciation is provided on a straight-line basis on all Ijarah Muntahia Bittamleek assets other than land (which is deemed to have an indefinite life), at rates calculated to write off the cost of each asset over the period of the lease.

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Non-trading investments

These are classified as held-to-maturity, available-for-sale or fair value through profit or loss.

All investments are initially recognised at cost, being the fair value of the consideration given including acquisition costs associated with the investment.

Following the initial recognition of investments, the subsequent period-end reporting values are determined as follows:

Investments held-to-maturity

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

2 ACCOUNTING POLICIES (Continued)

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments available-for-sale

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

Investments carried at fair value through profit or loss

Investments in this category are designated as such on initial recognition if these investments are evaluated on a fair value basis in accordance with the Bank’s risk management policy and its investment strategy. These include all private equity investments including those in joint ventures and associates. In accordance with AAOIFI, such investments would classify as “available for sale investments”.

Investments at fair value through profit or loss are recorded in the balance sheet at fair value. Changes in fair value are recorded as “Unrealised gains on investments designated at fair value through profit or loss” in statement of income.

Investment in associates

The Bank’s investments in its associates are accounted for under the equity method of accounting. An associate is an entity over which the Bank has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in the associate is carried in the balance sheet at cost plus post-acquisition changes in the Bank’s share of net assets of the associate. Losses in excess of the cost of the investment in an associate are recognised when the Bank has incurred obligations on its behalf. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised. The income statement reflects the Bank’s share of results of operations of the associate. Where there has been a change recognised directly in the equity of the associate, the Bank recognises its share of any changes and discloses this, when applicable, in the statement of changes in equity.

The reporting dates of the associate and the Bank are identical and the associates accounting policy conform to those used by the Bank for like transactions and events in similar transactions.

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

Investment properties

Investment properties are those held to earn rentals and/or for capital appreciation. These are initially recorded at cost, including acquisition charges associated with the property.

Subsequent to initial recognition, all investment properties are remeasured at fair value and changes in fair value are recognised in the statement of income as gain or loss in investment properties. The fair value of the investment properties is determined either based on valuations made by independent valuers or using internal models with consistent assumptions.

Investment reserve

Unrealised gains resulting from revaluation of “investments carried at fair value through profit or loss” and “investment properties” recorded in the statement of income are appropriated to an investment revaluation reserve in equity and are not available for distribution to the shareholders. Upon disposal of the “investment carried at fair value through profit or loss” or “investment properties”, the cumulative gains related to the investment are transferred to retained earnings and are available for distribution.

Subsidiaries or associates acquired with a view to sell

A subsidiary or an associate acquired with a view to subsequent disposal within 12 months are classified as “held-for-sale” when the sale is highly probable. Related assets and liabilities of the subsidiary are shown separately on the balance sheet as “Investments held-for-sale” and “Liabilities relating to investments held-for-sale”. Assets that are classified as held-for-sale are measured at the lower of carrying amount and fair value less costs to sell. Any resulting impairment loss reduces the carrying amount of the assets. Assets that are classified as held-for-sale are not depreciated.

Any impairment loss is recognised in the profit or loss for any initial and subsequent write down of these assets to fair value, less costs to sell. A gain for any subsequent increase in the fair value, less costs to sell, is recognised to the extent that it is not in excess of the cumulative impairment loss that was recognised.

Premises and equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment, other than freehold land and capital work-in-progress.

-	Computer hardware and software	3 to 5 years
-	Furniture and office equipments	3 to 5 years
-	Motor vehicle	5 years
-	Leasehold Improvements	Over the lease period

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

2 ACCOUNTING POLICIES (Continued)

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Treasury stock

Treasury stock is stated at cost with any gains and losses on sale recognised in equity.

Impairment and uncollectability of financial assets

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

Impairment is determined as follows:

- (a) for assets carried at amortised cost, impairment is based on estimated cash flows discounted at the original effective profit rate;
- (b) for assets carried at fair value, impairment is the difference between cost and fair value; and
- (c) for assets carried at cost, impairment is based on present value of future cash flows discounted at the current market rate of return for a similar financial asset.

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

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

Offsetting

Financial assets and financial liabilities can only be offset with the net amount being reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and the Bank intends to either settle on a net basis, or intends to realise the asset and settle the liability simultaneously.

Employees' end of service benefits

The Bank provides end of service benefits to its expatriate employees. Entitlement to these benefits is based upon the employees' final salary and length of service, subject to completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

For national employees, the Bank makes contributions to General Organisation for Social Insurance calculated as a percentage of the employees' salaries. The Bank's obligations are limited to these contributions, which are expensed when due.

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

Revenue recognition

Murabaha

Where the income is quantifiable and contractually determined at the commencement of the contract, income is recognised on a time-apportioned basis over the period of the contract based on the principal amounts outstanding. Where the income from a contract is not quantifiable, it is recognised when realised. Accrual of income is suspended when the Bank believes that the recovery of these amounts may be doubtful or normally when the repayments are overdue by 90 days, whichever is earlier.

Mudaraba

Income on Mudaraba transactions are recognised when the right to receive is established or these are declared by the Mudarib, whichever is earlier.

Dividends

Revenue is recognised when the Bank's right to receive the payment is established.

Ijarah

Ijarah Muntahia Bittamleek income is recognised on a time-proportionate basis over the lease term.

Fees and commission income

The Bank earns fee and commission income from a diverse range of services it provides its customers. Fee income can be divided into the following main categories:

Fee income on financing transactions: Fees earned on financing transactions include up-front fees and early maturity fees. These fees are recognised when earned. To the extent the fees are deemed yield enhancement they are recognised over the period of the financing contracts.

Fee income from transaction services: Fees arising from corporate finance, corporate advisory, arranging the sale of assets and wealth management are recognised upon completion of the underlying transaction or on a time proportionate basis when the fee is linked to time.

Fair value of financial assets

For investments that are traded in organised financial markets, fair value is determined by reference to the prevailing market bid price on the balance sheet date.

For investments where there is no quoted market price, a reasonable estimate of fair value is determined by reference to current market value of another instrument, which is substantially the same, or is based on the assessment of future cash flows. The cash equivalent values are determined by the Bank at current profit rates for contracts with similar terms and risk characteristics.

For investments having fixed or determinable payments fair value is based on the net present value of estimated future cash flows determined by the Bank using current profit rates for investments with similar terms and risk characteristics.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

2 ACCOUNTING POLICIES (Continued)

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Foreign currencies

Foreign currency transactions are recorded at rates of exchange prevailing at the dates of the transactions. Monetary assets and liabilities in foreign currencies at the balance sheet date are retranslated at market rates of exchange prevailing at that date. Gains and losses arising on translation are recognised in the statement of income. Non-monetary assets that are measured in terms of historical cost in foreign currencies are recorded at rates of exchange prevailing at the value dates of the transactions. Translation gains or losses on non-monetary items classified as “available-for-sale” are included in equity until the related assets are sold or derecognised at which time they are recognised in the statement of income. Translation gains on assets and liabilities classified as “fair value through profit or loss” are directly recognised in the statement of income.

Trade and settlement date accounting

Purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Bank commits to purchase or sell the asset.

Derecognition of financial assets

A financial asset (in whole or part) is derecognised either when the Bank has transferred substantially all the risk and rewards of ownership or when it has neither transferred nor retained substantially all the risks and rewards and when it no longer has control over the asset or a proportion of the asset.

Derecognition of financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

Fiduciary assets

Assets held in a fiduciary capacity are not treated as assets of the Bank.

Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank’s shareholders. Dividends for the year that are approved after the balance sheet date are disclosed as an event after the balance sheet date.

Unrestricted investment account holders (URIA)

All unrestricted investment accounts are carried at cost plus accrued profits less amounts repaid. Income to unrestricted investment account holders is allocated on the basis of their average daily balances in proportion to shareholders’ balances.

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

Zakah

In accordance with the Articles of Association, the Bank is required to pay Zakah on all realised retained earnings and reserves on behalf of the shareholders, excluding paid-up capital and share premium which are the responsibility of the shareholders. The Bank is obligated to calculate and notify individual shareholders of their share of Zakah payable. The Bank's Shari'a Supervisory Board approves these calculations. Zakah is treated as an appropriation from the retained earnings.

Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with banks with maturities of less than 90 days from the date of acquisition.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

3 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

As at 31 December 2007, financial instruments have been classified for the purpose of measurement under International Accounting Standard 39 Financial Instruments: Recognition and Measurement as follows:

	Financial assets at fair value through profit or loss BD	Financing and receivables BD	Financial assets at amortised cost BD	Financial liabilities at amortised cost BD	Total BD
ASSETS					
Cash and balances with					
Central Bank of Bahrain	-	-	15,173,663	-	15,173,663
Central Bank of Bahrain Sukuk	-	-	20,380,000	-	20,380,000
Murabaha and Mudaraba with					
banks	-	-	224,450,893	-	224,450,893
Murabaha financing	-	32,641,599	-	-	32,641,599
Ijarah Muntahia Bittamleek	-	10,435,863	-	-	10,435,863
Non-trading investments	62,735,696	-	-	-	62,735,696
Receivables	-	10,156,438	-	-	10,156,438
	62,735,696	53,233,900	260,004,556	-	375,974,152
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS					
Murabaha from banks	-	-	-	96,983,041	96,983,041
Murabaha from non-banks	-	-	-	106,908,709	106,908,709
Customers' current accounts	-	-	-	5,688,686	5,688,686
UNRESTRICTED INVESTMENT ACCOUNTS	-	-	-	19,769,585	19,769,585
	-	-	-	229,350,021	229,350,021

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

As at 31 December 2006, Financial instruments, were classified as follows:

	Financial assets at fair value through profit or loss BD	Financing and receivables BD	Financial assets at amortised cost BD	Financial liabilities at amortised cost BD	Total BD
ASSETS					
Cash and balances with					
Central Bank of Bahrain	-	-	2,942,042	-	2,942,042
Murabaha and Mudaraba with					
banks	-	-	105,089,786	-	105,089,786
Murabaha financing	-	22,963,267	-	-	22,963,267
Ijarah Muntahia Bittamleek	-	10,382,429	-	-	10,382,429
Non-trading investments	32,618,646	-	-	-	32,618,646
Receivables	-	8,510,867	-	-	8,510,867
	<u>32,618,646</u>	<u>41,856,563</u>	<u>108,031,828</u>	<u>-</u>	<u>182,507,037</u>
LIABILITIES AND UNRESTRICTED					
INVESTMENT ACCOUNTS					
Murabaha from banks	-	-	-	23,647,305	23,647,305
Murabaha from non-banks	-	-	-	20,111,967	20,111,967
Customers' current accounts	-	-	-	5,673,812	5,673,812
UNRESTRICTED INVESTMENT					
ACCOUNTS					
	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>49,433,084</u>	<u>49,433,084</u>

4 CASH AND BALANCES WITH CENTRAL BANK OF BAHRAIN

	2007 BD	2006 BD
Mandatory reserve with Central Bank of Bahrain	5,640,000	930,000
Cash and other balances with Central Bank of Bahrain	1,814,814	505,920
Balances with other banks	7,718,849	1,506,122
	<u>15,173,663</u>	<u>2,942,042</u>

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

5 MURABAHA AND MUDARABA WITH BANKS

	31 December 2007		
	Up to	3 months to	Total
	3 months	6 months	
	BD	BD	BD
GCC	199,822,903	376,366	200,199,269
Europe	24,251,624	-	24,251,624
	224,074,527	376,366	224,450,893

	31 December 2006		
	Up to	3 months to	Total
	3 months	6 months	
	BD	BD	BD
GCC	74,684,215	7,276,100	81,960,315
Arab World	-	7,540,000	7,540,000
Europe	15,589,471	-	15,589,471
	90,273,686	14,816,100	105,089,786

Deferred profit on Murabaha and Mudaraba with banks as of 31 December 2007 amounted to BD 188,345 (2006: BD 220,724).

6 MURABAHA AND IJARAH MUNTAHIA BITTAMLEEK

At 31 December 2007, no provisions existed for Murabaha and Ijarah Muntahia Bittamleek contracts (2006: Nil).

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

7 IJARAH MUNTAHIA BITTAMLEEK

This represents net investments in assets leased for periods which either approximate or cover major parts of the estimated useful lives of such assets. The lease agreements stipulate that the lessor undertakes to transfer the leased assets to the lessee upon receiving the final rental payment.

	2007	2006
	BD	BD
The future minimum lease receivable payments in aggregate are as follows:		
Due within one year	738,954	885,462
Due in one to five years	8,561,766	9,496,967
Due after five years	1,135,143	-
	10,435,863	10,382,429
Less: Deferred income	376,923	321,628
Present value of minimum lease payments	10,058,940	10,060,801
Allowance for doubtful Ijarah receivables	-	-
Net value of minimum lease payments receivable	10,058,940	10,060,801
	2007	2006
	BD	BD

Ijarah Muntahia Bittamleek are divided into the following asset classes:

Aviation	4,142,211	4,610,408
Land and buildings	5,916,729	5,450,393
	10,058,940	10,060,801

Income recognized on Ijarah financing in the year ended 31 December 2007 amountd to BD 905,497 (2006: BD 321,627).

8 NON-TRADING INVESTMENTS

	2007	2006
	BD	BD
Quoted	12,051,192	7,914,375
Unquoted	50,684,504	24,704,271
	62,735,696	32,618,646

These represent investments classified as fair value through profit or loss and are carried at fair value.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

9 INVESTMENT IN AN ASSOCIATE

During 2007 the Bank had taken a 20% stake in Al Salam Bank Algeria (ASBA), a bank incorporated in Algeria. Al Salam Bank Algeria is not listed on any public exchange. The following table illustrates the summarised financial information of the Bank's investment in ASBA:

	2007	2006
	BD	BD
Share of the associate's balance sheet:		
Assets	8,279,141	-
Liabilities	318,766	-
Net assets	7,960,375	-
Carrying amount of the investment	8,272,000	2,073,500
Share of associate's loss:		
Loss for the year	100,858	-

Al Salam Bank Algeria was in the process of being incorporated as of 31 December 2006, therefore no comparative figures are included.

10 RECEIVABLES AND PREPAYMENTS

	2007	2006
	BD	BD
Profit receivable on financing contracts	1,227,578	898,461
Prepayments	348,608	273,588
Other receivables	8,928,860	7,612,405
	10,505,046	8,784,454

Other receivables include advance payments amounting to BD 4,154,051 (2006: BD 7,540,000) for the acquisition of investments. The related acquisitions and transfers of title to the underlying investments were in the process of being concluded at the year-end.

11 OTHER LIABILITIES

	2007	2006
	BD	BD
Profit payable	1,176,903	161,845
Accounts payable and accruals	7,640,165	2,003,748
End of services benefits	137,574	58,270
	8,954,642	2,223,863

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

12 UNRESTRICTED INVESTMENT ACCOUNTS

Unrestricted investment account holders' funds are commingled with the Bank's funds and invested in short-term highly liquid Commodity Murabaha and/or Wakala deposits. According to the terms of acceptance of the unrestricted investment accounts, 100% of the funds are invested after deducting a mandatory reserve. All unrestricted investment accounts have no restriction on cash withdrawal, therefore the Mudarib fee ranges between 40% and 50%.

13 SHARE CAPITAL

	2007	2006
	BD	BD
Authorised:		
1,200,000,000 ordinary shares of BD 0.100 each	<u>120,000,000</u>	<u>120,000,000</u>
Issued and fully paid:		
1,200,000,000 ordinary shares of BD 0.100 each, issued against cash	<u>120,000,000</u>	<u>120,000,000</u>

It was resolved by the Extraordinary General Assembly meeting held on 10 September 2007 to split the nominal value of the issued and fully paid-up shares of the Bank from BD 1 each to 10 shares of 100 fils (BD 0.100) each. The resolution was implemented effective 18 November 2007. Accordingly, the number of authorised, issued and paid-up shares increased from 120 million ordinary shares to 1.2 billion ordinary shares. The calculation of earnings per share has been adjusted retroactively as required by IAS 33.

In 2006, the founders of the Bank subscribed for 65% of the paid-up capital and the remaining 35% of the shares were offered to the public. The initial public offer for 42 million shares was made at an issue price of BD 1.050 per share, including issue expenses of BD 0.050 per share, in February 2006. The share allotment was completed on 19 March 2006 with the approval of the Capital Markets Supervision Directorate of the CBB and the Bank issued 42,000,000 shares. The allotment process resulted in the Bank purchasing 17,203 shares, being fractional shares, as treasury stock at the issue price. The issue expenses collected on the shares issued were reimbursed to Co-Lead Manager as placement fee as per terms specified in the offering prospectus.

14 STATUTORY RESERVE

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

15 INVESTMENT RESERVE

During the year BD 11,079,352 (2006: BD 11,443,688) was transferred from retained earnings to the investment reserve. The reserve represents unrealised gains from revaluation of investments and investment properties carried at fair value through profit or loss, and is not available for distribution under the Bank's Shari'a policies until transferred back to retained earnings upon disposal of the assets and realisation of the gains.

16 FEES AND COMMISSION INCOME

	2007	2006
	BD	BD
Financing related fees and commissions	530,937	254,381
Transaction related fees	3,853,532	-
Fiduciary and other fees	96,172	-
	4,480,641	254,381

17 RELATED PARTY TRANSACTIONS

Related parties comprise major shareholders, directors of the Bank, close members of their families, entities owned or controlled by them and companies affiliated by virtue of common ownership or directors with that of the Bank. The transactions with these parties were made on commercial terms.

The significant balances with related parties at 31 December 2007 were as follows:

	2007			
	Joint ventures	Directors and related entities	Senior management	Total
	BD	BD	BD	BD
Assets				
Murabaha financing	-	4,603,987	45,896	4,649,883
Ijarah Muntahia Bittamleek	-	6,807,337	253,129	7,060,466
Receivables and prepayments	600	196,325	1,275	198,200
Liabilities				
Murabaha from non-banks	1,453,500	568,410	576,490	2,598,400
Customer current accounts	-	164,027	21,767	185,794
Other liabilities	2,985	1,291	62,583	66,859
Unrestricted investment accounts	-	50,315	608,454	658,769

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31 December 2007

The income and expenses in respect of related parties included in the financial statements are as follows:

	2007			
	Joint ventures BD	Directors and related entities BD	Senior management BD	Total BD
Income				
Income from Murabaha and Mudaraba	-	557,661	3,139	560,800
Income from Ijarah Muntahia Bittamleek	-	371,853	7,166	379,019
Fees and commission income (note 16)	-	19,250	938	20,188
Expenses				
Profit paid on Murabaha from non-banks	165,372	42,062	26,002	233,436
Share of profits on unrestricted investment accounts	-	39	1,082	1,121
2006				
	Joint ventures BD	Directors and related entities BD	Senior management BD	Total BD
Assets				
Murabaha financing	-	1,221,011	39,447	1,260,458
Ijarah Muntahia Bittamleek	-	4,800,884	-	4,800,884
Liabilities				
Customer current accounts	361,711	-	-	361,711
Murabaha from non-banks	4,332,436	9,052,950	-	13,385,386

The income and expenses in respect of related parties included in the financial statements are as follows:

Income				
Income from Murabaha and Mudaraba	-	-	223	223
Income from Ijarah Muntahia Bittamleek	-	158,553	-	158,553
Fees and commission income (note 16)	-	21,101	-	21,101
Expenses				
Profit paid on Murabaha from non-banks	63,099	65,630	-	128,729
Share of profits on unrestricted investment accounts	-	-	-	-

In 2006, income from Murabaha and Mudaraba received from related parties included a profit of BD 3.77 million which was earned and received through the co-lead manager, a related party, in connection with investments made by the related party on behalf of the Bank using the IPO proceeds.

Compensation of key management personnel, consisting solely of short-term benefits, paid during the year was BD 2,329,980 (2006: BD 1,281,398).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

18 COMMITMENTS

Undrawn commitments

The Bank has a contracted financing commitment to the extent of BD 6,409,746 (2006: BD 2,790,779) which remained undrawn as at the year end. In addition, the Bank had an undrawn capital commitment of BD 32,601,265 (2006: BD 2,008,000) as at the year end on account of investments. Commitments generally have fixed expiration dates, or other termination clauses. Since commitment may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

Operating lease commitment - Bank as lessee

In 2006, the Bank entered into a five-year operating lease for its headquarters premises. Future minimal rentals payable under the non-cancellable lease as at 31 December 2007 are as follows:

	2007	2006
	BD	BD
Within 1 year	366,373	322,328
After one year but not more than five years	821,980	978,984
TOTAL	1,188,353	1,301,312

19 CREDIT RISK

Risk management

Credit risk is the risk that one party to a financial contract will fail to discharge an obligation and cause the other party to incur a financial loss. The Bank attempts to control credit risk by monitoring credit exposures, setting limits for transactions with counterparties, and continually assessing the creditworthiness of counterparties.

In addition to monitoring credit limits, the Bank manages the credit exposures by entering into collateral arrangements with counterparties in appropriate circumstances and by limiting the duration of the exposure.

Type of credit risk

Various contracts entered into by the Bank comprise Murabaha receivables, Mudaraba investments and Ijarah Muntahia Bittamleek contracts. Murabaha receivables contracts cover land, buildings, commodities, motor vehicles and others. Mudaraba investments consist of financing transactions entered through other Islamic banks and financial institutions. The various financial instruments are:

Murabaha receivables

The Bank arranges Murabaha transactions by buying an asset (which represents the object of the Murabaha) and then selling this asset to customers (beneficiary) after adding a margin of profit over the cost. The sale price (cost plus profit margin) is repaid in installments over the agreed period.

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

Ijarah Muntahia Bittamleek

The legal title of the leased asset under Ijarah Muntahia Bittamleek passes to the lessee at the end of the Ijarah term, provided that all Ijarah instalments are settled and the lessee purchases the asset.

a) The credit quality of Murabaha and Mudaraba with banks subject to credit risk is as follows:

31 December 2007					
	Neither past due nor impaired			Past due or	Total
	'A' Rated	'B' Rated	Unrated	individually	
	BD	BD	BD	impaired	
	BD	BD	BD	BD	BD
Murabaha and Mudaraba with banks	135,572,893	51,822,000	37,056,000	-	224,450,893
	135,572,893	51,822,000	37,056,000	-	224,450,893
31 December 2006					
	Neither past due nor impaired			Past due or	Total
	'A' Rated	'B' Rated	Unrated	individually	
	BD	BD	BD	impaired	
	BD	BD	BD	BD	BD
Murabaha and Mudaraba with banks	59,576,067	9,264,552	36,249,167	-	105,089,786
	59,576,067	9,264,552	36,249,167	-	105,089,786

The ratings referred to in the above tables are by one or more of the 4 international rating agencies (Standards & Poors, Moody's, Fitch and Capital Intelligence).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

19 CREDIT RISK (Continued)

b) The credit quality of Murabaha financing and Ijarah Muntahia Bittamleek subject to credit risk, based on internal credit ratings, is as follows:

31 December 2007					
	Neither past due nor impaired			Past due BD	Total BD
	Satisfactory BD	Watch List BD	Substandard but not impaired BD		
Murabaha financing	27,040,226	-	-	5,601,373	32,641,599
Ijarah Muntahia Bittamleek	10,429,788	-	-	6,075	10,435,863
Guarantees and irrevocable commitments to extend credit	6,409,746	-	-	-	6,409,746
	43,879,760	-	-	5,607,448	49,487,208
31 December 2006					
	Neither past due nor impaired			Past due BD	Total BD
	Satisfactory BD	Watch List BD	Substandard but not impaired BD		
Murabaha financing	22,963,267	-	-	-	22,963,267
Ijarah Muntahia Bittamleek	10,382,429	-	-	-	10,382,429
Guarantees and irrevocable commitments to extend credit	2,790,779	-	-	-	2,790,779
	36,136,475	-	-	-	36,136,475

All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly.

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

c) Past due but not impaired Murabaha financing, and Ijarah Muntahia Bittamleek are analysed as follows:

	31 December 2007			
	0-30 days	30-90 days	> 90 days	Total
	BD	BD	BD	BD
Murabaha financing	997,380	3,480,396	1,123,590	5,601,366
Ijarah Muntahia Bittamleek	252	-	5,823	6,075
	997,632	3,480,396	1,129,413	5,607,441
	31 December 2006			
	0-30 days	30-90 days	> 90 days	Total
	BD	BD	BD	BD
Murabaha financing	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	-	-
	-	-	-	-

Of the total aggregate amount of past due but not impaired Murabaha and Ijarah financing, BD 997,380 is covered by a collateral of BD 1,717,930.

The maximum credit risk, without taking into account the fair value of any collateral and Shari'a-compliant netting agreements, is limited to the amounts on the balance sheet plus commitments to customers disclosed in note 18.

No financial assets were renegotiated during this or any previous years.

At 31 December 2007, the amount of credit exposure in excess of 10% of equity to individual counterparties was nil (2006: nil).

20 CONCENTRATIONS

Concentrations 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 indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographic location. The Bank manages its credit risk exposure through diversification of financing activities to avoid undue concentrations of risks with customers in specific locations or businesses.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

20 CONCENTRATIONS (Continued)

The distribution of assets, liabilities and unrestricted investment accounts by geographic region and industry sector was as follows:

	2007			2006		
	Assets BD	Liabilities, unrestricted investment accounts and equity BD	Commitments BD	Assets BD	Liabilities, unrestricted investment accounts and equity BD	Commitments BD
Geographic region						
GCC	355,982,172	223,612,663	6,409,746	153,948,549	48,318,047	2,790,779
Arab World	10,201,788	4,177,469	-	17,250,408	-	-
Europe	27,161,365	9,930,884	-	16,581,353	3,338,900	-
Asia	3,570,847	576,258	26,344,625	255,606	-	2,008,000
America	779,299	7,389	-	22,620	-	-
Others	80,069	-	6,256,640	-	-	-
	397,775,540	238,304,663	39,011,011	188,058,536	51,656,947	4,798,779
Equity	-	159,470,877	-	-	136,401,589	-
	397,775,540	397,775,540	39,011,011	188,058,536	188,058,536	4,798,779
Industry sector						
Trading and manufacturing	5,217,109	71,317	1,750,000	6,668,012	3,225,972	-
Banks and financial institutions	302,534,030	173,002,367	-	122,256,947	38,716,628	-
Real estate	56,991,542	6,152,146	8,537,265	51,992,775	6,787,056	2,008,000
Aviation	7,159,208	-	-	4,800,884	-	-
Individuals	10,846,341	49,883,876	4,659,746	39,446	115,661	2,790,779
Others	15,027,310	9,194,957	24,064,000	2,300,472	2,811,630	-
	397,775,540	238,304,663	39,011,011	188,058,536	51,656,947	4,798,779
Equity	-	159,470,877	-	-	136,401,589	-
	397,775,540	397,775,540	39,011,011	188,058,536	188,058,536	4,798,779

NOTES TO THE FINANCIAL STATEMENTS

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21 MARKET RISK

Market risk arises from fluctuations in global yields on financial instruments and foreign exchange rates that could have an indirect effect on the Bank's assets value and equity prices. The Board has set limits on the risk that may be accepted. This is monitored on a regular basis by the Asset and Liability Committee of the Bank.

22 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 Bank's Investment Committee.

The effect on income (as a result of changes in the fair values of non-trading investments held at fair value through profit or loss) solely due to reasonably possible changes in equity prices, is as follows:

	2007			
	Change in index %	Effect on net profit BD	Change in index %	Effect on net profit BD
Quoted:				
GCC	10	1,091,361	(10)	(1,091,361)
Unquoted	10	5,068,450	(10)	(5,068,450)
	2006			
	Change in index %	Effect on net profit BD	Change in index %	Effect on net profit BD
Quoted:				
GCC	10	737,100	(10)	(737,100)
Unquoted	10	2,470,427	(10)	(2,470,427)

23 PROFIT RETURN RISK

The Bank has exposure to fluctuations in the profit rates on its assets and liabilities. The Bank recognises income on certain financial assets on a time-apportioned basis. The Bank has set limits for profit return risk and these are monitored on an ongoing basis by the Bank's Asset Liability Committee (ALCO). The following table indicates the gaps in the profit rate profile at the balance sheet date and the effective yield/cost, set out as a percentage of principal, of assets/liabilities on which income is generated or profit is payable.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

23 PROFIT RETURN RISK (Continued)

The Bank manages exposures to the effects of various risks associated with fluctuations in the prevailing levels of market profit rates on its financial position and cash flows.

The Bank's profit sensitivity position based on the earlier of contractual repricing arrangements or maturity at 31 December 2007 has been shown in the table below:

	31 December 2007					Effective profit rates
	Up to 3 months BD	3 months to 1 year BD	1 to 5 years BD	Over 5 years BD	Not exposed by profit rate risk BD	
ASSETS						
Cash and balances with						
Central Bank of Bahrain	-	-	-	-	15,173,663	15,173,663
Central Bank of Bahrain						
Sukuk	1,560,000	18,820,000	-	-	-	20,380,000 5.42%
Murabaha and Mudaraba						
with banks	224,074,527	376,366	-	-	-	224,450,893 4.09%
Murabaha financing	18,750,210	5,524,705	8,246,684	120,000	-	32,641,599 8.41%
Ijarah Muntahia Bittamleek	107,861	631,093	8,561,766	1,135,143	-	10,435,863 8.04%
Non-trading investments	-	-	2,275,111	-	60,460,585	62,735,696 9.50%
Investment in an associate	-	-	-	-	8,272,000	8,272,000
Investment properties	-	-	-	-	1,177,528	1,177,528
Receivables and						
prepayments	501,955	312,342	407,104	6,177	9,277,468	10,505,046
Premises and equipment	-	-	-	-	2,979,252	2,979,252
Investments held-for-sale	-	-	-	-	9,024,000	9,024,000
	244,994,553	25,664,506	19,490,665	1,261,320	106,364,496	397,775,540
LIABILITIES AND UNRESTRICTED						
INVESTMENT ACCOUNTS						
Murabaha from banks	96,983,041	-	-	-	-	96,983,041 4.95%
Murabaha from						
non-banks	101,975,729	4,742,980	190,000	-	-	106,908,709 5.27%
Customers' current						
accounts	-	-	-	-	5,688,686	5,688,686
Other liabilities	895,718	51,558	6,747	170,222	7,830,397	8,954,642
UNRESTRICTED						
INVESTMENT						
ACCOUNTS						
	19,769,585	-	-	-	-	19,769,585 3.82%
	219,624,073	4,794,538	196,747	170,222	13,519,083	238,304,663
Profit pricing gap	25,370,480	20,869,968	19,293,918	1,091,098	92,845,413	159,470,877
Cumulative profit						
pricing gap	25,370,480	46,240,448	65,534,366	66,625,464	159,470,877	

NOTES TO THE FINANCIAL STATEMENTS

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31 December 2006							
	Up to 3 months BD	3 months to 1 year BD	1 to 5 years BD	Over 5 years BD	Not exposed by profit rate risk BD	Total BD	Effective profit rates
ASSETS							
Cash and balances with Central Bank of Bahrain	-	-	-	-	2,942,042	2,942,042	
Murabaha and Mudaraba with banks	90,273,686	14,816,100	-	-	-	105,089,786	5.28%
Murabaha financing Ijarah Muntahia Bittamleek	3,073,000	10,088,261	9,802,006	-	-	22,963,267	8.20%
	2,175,236	3,843,400	4,363,793	-	-	10,382,429	8.45%
Non-trading investments	-	-	-	-	32,618,646	32,618,646	
Investment in an associate	-	-	-	-	2,073,500	2,073,500	
Investment properties	-	-	-	-	1,177,528	1,177,528	
Receivables and prepayments	253,613	1,864	113,555	529,429	7,885,993	8,784,454	
Premises and equipment	-	-	-	-	2,026,884	2,026,884	
	<u>95,775,535</u>	<u>28,749,625</u>	<u>14,279,354</u>	<u>529,429</u>	<u>48,724,593</u>	<u>188,058,536</u>	
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS							
Murabaha from banks	23,647,305	-	-	-	-	23,647,305	5.26%
Murabaha from non-banks	20,111,967	-	-	-	-	20,111,967	5.20%
Customers' current accounts	-	-	-	-	5,673,812	5,673,812	
Other liabilities	161,845	-	-	-	2,062,018	2,223,863	
UNRESTRICTED INVESTMENT ACCOUNTS							
	-	-	-	-	-	-	
	<u>43,921,117</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,735,830</u>	<u>51,656,947</u>	
Profit pricing gap	<u>51,854,418</u>	<u>28,749,625</u>	<u>14,279,354</u>	<u>529,429</u>	<u>40,988,763</u>	<u>136,401,589</u>	
Cumulative profit pricing gap	<u>51,854,418</u>	<u>80,604,043</u>	<u>94,883,397</u>	<u>95,412,826</u>	<u>136,401,589</u>		

The effect on income solely due to reasonably possible immediate and sustained changes in profit return rates, affecting both floating rate assets and liabilities and fixed rate assets and liabilities with maturities less than one year are as follows:

	2007			
	Change in rate %	Effect on net profit BD	Change in rate %	Effect on net profit BD
US Dollars	1	233,879	(1)	(233,879)
Bahraini Dinars	1	361,379	(1)	(361,379)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

23 PROFIT RETURN RISK (Continued)

	2006			
	Change in	Effect on	Change in	Effect on
	rate	net profit	rate	net profit
	%	BD	%	BD
US Dollars	1	434,358	(1)	(434,358)
Bahraini Dinars	1	299,712	(1)	(299,712)

24 CURRENCY RISK

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on positions by currency. Positions are monitored on a periodic basis by the Bank's Asset Liability Committee to ensure positions are maintained within established limits.

Substantial portion of the Bank's assets and liabilities are denominated in Bahrain Dinars or US Dollars. The Bank had the following significant net exposures denominated in foreign currencies as of 31 December :

	2007	2006
	BD	BD
US Dollars	12,150,234	57,231,592
Saudi Riyals	10,889,630	8,705,404

The effect on income solely due to reasonably possible immediate and sustained changes in exchange rates is as follows:

	2007			
	Change in	Effect on	Change in	Effect on
	rate	net profit	rate	net profit
	%	BD	%	BD
US dollars to Bahraini Dinar	1	121,502	(1)	(121,502)

	2006			
	Change in	Effect on	Change in	Effect on
	rate	net profit	rate	net profit
	%	BD	%	BD
US dollars to Bahraini Dinar	1	572,316	(1)	(572,316)

25 LIQUIDITY RISK

Liquidity risk is the risk that the Bank will be unable to meet its liabilities as they fall due. Liquidity risk can be caused by market disruptions or credit downgrades which may impact certain sources of funding. To mitigate this risk, management has diversified funding sources and assets are managed with liquidity in mind, maintaining an adequate balance of cash, cash equivalents and readily marketable securities. Liquidity position is monitored on an ongoing basis by the Bank's Asset Liability Committee.

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

The table below summarizes the maturity profile of the Bank's assets and liabilities based on remaining contractual repayment arrangements. Maturity periods for investments are based on expected exit dates.

The maturity profile of assets and liabilities as at 31 December 2007 is as follows:

	31 December 2007				Total BD
	Up to 3 months BD	3 months to 1 year BD	1 to 5 years BD	Over 5 years BD	
ASSETS					
Cash and balances with Central Bank of Bahrain	15,173,663	-	-	-	15,173,663
Central Bank of Bahrain Sukuk	1,560,000	-	18,820,000	-	20,380,000
Murabaha and Mudaraba with banks	224,074,527	376,366	-	-	224,450,893
Murabaha financing	13,862,210	5,524,705	13,134,684	120,000	32,641,599
Ijarah Muntahia Bittamleek	107,861	631,093	8,561,767	1,135,142	10,435,863
Non-trading investments	-	-	62,735,696	-	62,735,696
Investment in an associate	-	-	-	8,272,000	8,272,000
Investment properties	-	1,177,528	-	-	1,177,528
Receivables and prepayments	9,632,557	56,096	810,216	6,177	10,505,046
Premises and equipment	-	-	2,979,252	-	2,979,252
Investments held-for-sale	-	9,024,000	-	-	9,024,000
	264,410,818	16,789,788	107,041,615	9,533,319	397,775,540
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS					
Murabaha from banks	96,983,041	-	-	-	96,983,041
Murabaha from non-banks	101,975,729	4,932,980	-	-	106,908,709
Customers' current accounts	5,688,686	-	-	-	5,688,686
Other liabilities	8,726,115	51,683	6,622	170,222	8,954,642
UNRESTRICTED INVESTMENT ACCOUNTS	19,769,585	-	-	-	19,769,585
	233,143,156	4,984,663	6,622	170,222	238,304,663
Liquidity gap	31,267,662	11,805,125	107,034,993	9,363,097	159,470,877
Cumulative liquidity gap	31,267,662	43,072,787	150,107,780	-	-

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

25 LIQUIDITY RISK (Continued)

	31 December 2006				Total BD
	Up to 3 months BD	3 months to 1 year BD	1 to 5 years BD	Over 5 years BD	
ASSETS					
Cash and balances with Central Bank of Bahrain	2,942,042	-	-	-	2,942,042
Murabaha and Mudaraba with banks	90,273,686	14,816,100	-	-	105,089,786
Murabaha financing	3,073,000	11,428,760	8,461,507	-	22,963,267
Ijarah Muntahia Bittamleek	354,774	534,408	9,493,247	-	10,382,429
Non-trading investments	-	-	32,618,646	-	32,618,646
Investment in an associate	-	-	-	2,073,500	2,073,500
Investment properties	-	-	-	1,177,528	1,177,528
Receivables and prepayments	996,431	7,788,023	-	-	8,784,454
Premises and equipment	-	-	2,026,884	-	2,026,884
	<u>97,639,933</u>	<u>34,567,291</u>	<u>52,600,284</u>	<u>3,251,028</u>	<u>188,058,536</u>
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS					
Murabaha from banks	23,647,305	-	-	-	23,647,305
Murabaha from non-banks	20,111,967	-	-	-	20,111,967
Customers' current accounts	5,673,812	-	-	-	5,673,812
Other liabilities	2,223,863	-	-	-	2,223,863
UNRESTRICTED INVESTMENT ACCOUNTS	-	-	-	-	-
	<u>51,656,947</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>51,656,947</u>
Liquidity gap	<u>45,982,986</u>	<u>34,567,291</u>	<u>52,600,284</u>	<u>3,251,028</u>	<u>136,401,589</u>
Cumulative liquidity gap	<u>45,982,986</u>	<u>80,550,277</u>	<u>133,150,561</u>		

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

26 SEGMENT INFORMATION

Primary segment information

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

- Banking** principally managing Shari'a compliant profit sharing investment accounts, and offering Shari'a compliant financing contracts and other Shari'a-compliant products. This segment comprises corporate banking, retail banking and private banking and wealth management.
- Treasury** principally handling Shari'a-compliant money market, trading and treasury services including short-term commodity Murabaha.
- Investments** principally the Banks' proprietary portfolio and serving clients with a range of investment products, funds and alternative investments.
- Capital** manages the undeployed capital of the bank by investing it in high quality financial instruments, incurs all expenses in managing such investments and accounts for the capital governance related expenses.

These segments are the basis on which the Bank reports its primary segment information. Transactions between segments are conducted at estimated market rates on an arm's length basis. Transfer charges are based on a pool rate which approximates the cost of funds.

Segment information for the year ended 31 December 2007 was as follows:

	31 December 2007				
	Banking	Treasury	Investments	Capital	Total
	BD	BD	BD	BD	BD
Operating income	12,972,517	866,524	11,184,478	8,829,000	33,852,519
Segment result	8,000,973	51,399	8,335,463	6,761,159	23,148,994
Other information					
Segment assets	42,574,473	175,158,216	84,587,099	95,455,752	397,775,540
Segment liabilities, URIA and equity	126,635,534	104,044,820	23,241,303	143,853,883	397,775,540

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 December 2007

26 SEGMENT INFORMATION (Continued)

	31 December 2006				
	Banking BD	Treasury BD	Investments BD	Capital BD	Total BD
Operating income	846,293	1,022,217	11,008,323	7,552,000	20,428,833
Segment result	<u>26,546</u>	<u>44,901</u>	<u>10,634,405</u>	<u>5,712,940</u>	<u>16,418,792</u>
Other information					
Segment assets	<u>30,815,622</u>	<u>19,534,393</u>	<u>46,566,958</u>	<u>91,141,563</u>	<u>188,058,536</u>
Segment liabilities, URIA and equity	<u>26,043,987</u>	<u>23,712,259</u>	<u>327,435</u>	<u>137,974,855</u>	<u>188,058,536</u>

Secondary segment information

The Bank primarily operates in the GCC and derives substantially all its operating income and incurs all operating expenses in the GCC.

27 FIDUCIARY ASSETS

Funds under management at the year-end amounted to BD 26,202,212 (2006: BD 22,041,590). These assets are held in a fiduciary capacity and are not included in the balance sheet.

28 SHARI'A SUPERVISORY BOARD

The Bank's Shari'a Supervisory Board consists of four Islamic scholars who review the Bank's compliance with general Shari'a principles and specific fatwa's, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Bank to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

29 FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Bank's financial instruments are not significantly different from their book values as at 31 December 2007.

30 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

As at 31 December 2007, the Bank received income from non-Islamic institution totaling BD 151 (2006: Nil). These funds were held as payable to charity as they are prohibited by Shari'a law.

NOTES TO THE FINANCIAL STATEMENTS

31 December 2007

31 SOCIAL RESPONSIBILITY

The Bank discharges its social responsibility through Zakah, charity fund expenditures and donations to the good faith qard fund which is used for charitable purposes. During the period the Bank incurred an amount of BD 35,100 (2006: BD 8,274) on account of charitable donations.

32 ZAKAH

The total Zakah payable as of 31 December 2007 amounted to BD 4,051,134 of which BD 529,087, representing the Zakah on the statutory reserve, general reserve and retained earnings balances for the period from 19 January 2006 to 31 December 2007, is payable by the Bank. The remaining Zakah balance amounting to BD 3,522,047 or 2.94 fils per share is due and payable by the shareholders.

33 CAPITAL

The adequacy of the Bank's capital is monitored using, primarily, the rules and ratios established by the Basel Committee on Banking Supervision and adopted by the Central Bank of Bahrain. The primary objective of the Bank's capital management is to ensure that it complies with externally imposed capital requirements. The Bank complied in full with all externally imposed capital requirements during the years ended 31 December 2007 and 31 December 2006.

The risk assets ratio calculations, in accordance with the 'Basel II' capital adequacy guidelines of the Central Bank of Bahrain are as follows:

	2007	2006
	BD	BD
Capital Base (Tier 1)	126,809,000	132,412,000
Credit risk weighted exposures	208,682,000	133,656,000
Market risk weighted exposures	775,000	268,000
Operational risk weighted exposures	50,888,000	32,064,000
Total risk weighted exposure	260,345,000	165,988,000
Capital adequacy	48.7%	79.8%
Minimum requirement	12.0%	12.0%

34 COMPARATIVE FIGURES

Certain of the prior year's figures have been reclassified to conform to the presentation adopted in the current period. Such reclassification did not affect previously reported net income or shareholders' equity.