Seera Investment Bank B.S.C. (c)

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2011

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF SEERA INVESTMENT BANK B.S.C. (c)

We have audited the accompanying consolidated statement of financial position of Seera Investment Bank B.S.C. (c) ("the Bank") and its subsidiaries ("the Group") as of 31 December 2011, and the related consolidated statements of income, cash flows and changes in owners' equity for the year then ended. These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a Rules and Principles are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2011, the results of its operations, its cash flows and changes in owners' equity for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF SEERA INVESTMENT BANK B.S.C. (c) (continued)

Other Matters

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 2), we report that:

a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; and

b) the financial information contained in the Report of the Board of Directors is consistent with the consolidated financial statements.

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6) and CBB directives, or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2011 that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests. The Bank has also complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

21 February 2012
Manama, Kingdom of Bahrain

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2011

	Notes	***2011 US$ '000***	*2010 US$ '000*
ASSETS			
Cash and balances with banks	4	**12,045**	18,486
Due from banks and financial institutions	5	**197,271**	34,286
Non-trading investments	6	**18,752**	21,494
Investments in leases	7	**-**	93,390
Investment in ijarah assets	8	**260,597**	-
Net assets of disposal group classified as held for sale	9	**14,630**	14,953
Investment property	10	**10,476**	10,476
Goodwill and intangible assets	11	**-**	165,206
Other assets	12	**6,017**	49,844
Property and equipment	13	**7,008**	9,590
TOTAL ASSETS		**526,796**	417,725
LIABILITIES AND OWNERS' EQUITY			
LIABILITIES			
Term financing	14	**164,104**	-
Due to banks and financial institutions		**-**	101,338
Other liabilities	15	**19,644**	15,455
TOTAL LIABILITIES		**183,748**	116,793
OWNERS' EQUITY			
Share capital	16	**291,286**	291,286
Reserves	16	**9,009**	4,565
Retained earnings / (Accumulated losses)		**26,896**	(27,396)
Equity attributable to shareholders of the parent		**327,191**	268,455
Non-controlling interest		**15,857**	32,477
TOTAL OWNERS' EQUITY		**343,048**	300,932
TOTAL LIABILITIES AND OWNERS' EQUITY		**526,796**	417,725

Mr. Asaad Al Banwan
Chairman

Mr. Khalid Al Nasser
Board Member

Mr. Abdulla Janahi
Chief Executive Officer

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

Seera Investment Bank B.S.C. (c)

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2011

	Notes	***2011 US$ '000***	*2010 US$ '000*
Rental income from investments in leases		**-**	34,313
Rental Income from investments in ijarah assets		**35,906**	-
Rental expense from investments in leases		**-**	(26,409)
Depreciation on investment in ijarah assets	8	**(16,007)**	-
Management fees relating to leases		**(1,265)**	(1,382)
Financing cost relating to term financing obtained to purchase ijarah assets		**(9,187)**	-
Net income from investment in ijarah assets / leases		**9,447**	6,522
Profit on amounts due from banks and financial institutions		**1,185**	205
Profit on amounts due to banks and financial institutions		**(227)**	(219)
Net funding income / (cost)		**958**	(14)
Realised gain on disposal of an investment	3	**76,048**	-
Net income from non-banking activities	17	**-**	7,153
Income from non-trading investments	18	**126**	2,209
Fee and other income		**632**	674
TOTAL INCOME		**87,211**	16,544
Expenses			
Staff expenses		**7,973**	5,981
General and administration expenses	19	**3,497**	3,020
Foreign exchange loss / (gain)		**932**	(392)
Depreciation on property and equipment	13	**1,433**	1,661
TOTAL EXPENSES		**13,835**	10,270
NET INCOME FOR THE YEAR BEFORE UNREALISED LOSS AND PROVISIONS		**73,376**	6,274
Unrealised loss on investment property	10	**-**	(978)
(Provisions) / write back	20	**(12,000)**	1,950
NET PROFIT FOR THE YEAR		**61,376**	7,246
Attributable to:			
Shareholders of the parent		**60,325**	5,545
Non-controlling interest		**1,051**	1,701
		61,376	7,246

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

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2011

	Notes	**2011 US$ '000**	2010 US$ '000
OPERATING ACTIVITIES			
Net profit for the year		**61,376**	7,246
Adjustments for:			
Provision for employees' end of service benefits	15	**246**	332
Depreciation relating to investments in ijarah assets	8	**16,007**	-
Depreciation relating to property and equipment	13	**1,433**	1,661
Gain on disposal of property and equipment		**(1)**	(78)
Amortisation of intangible assets	17	**-**	5,088
Income from non-trading investments	18	**-**	(2,209)
Provisions / (write back)		**12,000**	(1,950)
Unrealised loss on investment property	10	**-**	978
Realised gain on disposal of investment	3	**(74,713)**	-
		16,348	11,068
Changes in operating assets and liabilities:			
Due to banks and financial institutions		**(14,973)**	(15,794)
Other assets		**1,487**	(5,131)
Other liabilities		**4,094**	(2,595)
Net cash from / (used in) operating activities		**6,956**	(12,452)
INVESTING ACTIVITIES			
Proceeds from disposal of an investment		**182,358**	-
Proceeds from disposal of non-trading investments		**509**	9,415
Proceeds from disposal of property and equipment		**7**	97
Purchase of property and equipment	13	**(11)**	(110)
Net cash from investing activities		**182,863**	9,402
FINANCING ACTIVITIES			
Term financing		**(19,110)**	-
Dividend received	18	**126**	-
Non-controlling interest		**(487)**	(450)
Net cash used in financing activities		**(19,471)**	(450)
INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS		**170,348**	(3,500)
Cash and cash equivalents at beginning of the year		**52,772**	42,303
Cash and cash equivalents of investment sold	3	**(13,804)**	13,969
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	21	**209,316**	52,772

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

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

For the year ended 31 December 2011

	Equity attributable to shareholders of the parent							
	Share capital US$ '000	*Statutory reserve US$ '000*	*Investment fair value reserve US$ '000*	*Foreign currency translation reserve US$ '000*	*Retained Earnings/ (Accumulated losses) US$ '000*	*Total US$ '000*	*Non-controlling interest US$ '000*	*Total owners' equity US$ '000*
Balance at 1 January 2011	291,286	2,557	351	1,657	(27,396)	268,455	32,477	300,932
Net income for the year	-	-	-	-	60,325	60,325	1,051	61,376
Dividends paid by a subsidiary	-	-	-	-	-	-	(487)	(487)
Disposal of an investment (Note 3)	-	-	-	(1,657)	-	(1,657)	(17,184)	(18,841)
Transferred to statutory reserve	-	6,033	-	-	(6,033)	-	-	-
Unrealised gain on re-measurement to fair value	-	-	68	-	-	68	-	68
Balance at 31 December 2011	**291,286**	**8,590**	**419**	**-**	**26,896**	**327,191**	**15,857**	**343,048**
Balance at 1 January 2010	291,286	2,002	418	-	(32,804)	260,902	15,110	276,012
Net income for the year	-	-	-	-	5,545	5,545	1,701	7,246
Dividends paid by subsidiaries	-	-	-	-	-	-	(450)	(450)
Acquisition of a subsidiary	-	-	-	-	-	-	15,824	15,824
Exchange differences on translation of foreign operations	-	-	-	1,657	-	1,657	292	1,949
Transferred to statutory reserve	-	555	-	-	(555)	-	-	-
Unrealised losses on re-measurement to fair value	-	-	(67)	-	418	351	-	351
Balance at 31 December 2010	291,286	2,557	351	1,657	(27,396)	268,455	32,477	300,932

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

1 INCORPORATION AND ACTIVITIES

Seera Investment Bank B.S.C. (c) ["the Bank"] was incorporated on 5th of August 2006, under commercial registration number 62003 as a Bahrain Joint Stock Company (closed). The Bank’s registered office is Building 2431, Road 2831, Block 428, Seef, Kingdom of Bahrain.

The Bank operates under an Islamic Wholesale Banking License issued by the Central Bank of Bahrain ["the CBB"]. The Bank and its subsidiaries ["the Group"] aim to provide a full range of investment banking products and services that are compliant with Shari'a principles.

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 21 February 2012.

2 SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

These consolidated financial statements have been prepared in accordance with the Financial Accounting Standards [“FAS”] issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ["AAOIFI"], the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Group, the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6) and CBB directives. In accordance with the requirements of AAOIFI, for matters for which no AAOIFI standards exist, the Bank uses the relevant International Financial Reporting Standards ["IFRS"] issued by the International Accounting Standards Board ["IASB"].

2.2 Accounting convention

The consolidated financial statements have been prepared on a historical cost basis, except for investment property, and certain investments classified as "non-trading investments" that have been measured at fair value.

The consolidated financial statements have been presented in United States Dollar ["US$"], being the functional currency of the Group. All values are rounded to the nearest thousand ["US$ '000"] except when indicated otherwise.

The following is a summary of significant accounting policies adopted in preparing the consolidated financial statements. These accounting policies are consistent with those used in the previous year, except as noted below:

2.2.1 New and amended accounting standards, interpretations and framework

During 2010, AAOFI amended its conceptual framework and issued new Financial Accounting Standard (FAS 25) "Investment in sukuk, shares and similar instruments", which were effective as of 1 January 2011.

Conceptual Framework for Financial Reporting by Islamic Financial Institutions

The amended conceptual framework provides the basis for the financial accounting standards issued by AAOFI. The amended framework introduces the concept of substance and form, compared to the concept of form over substance. The framework states that it is necessary that information, transactions and other events are accounted for and presented in accordance with their substance and economic reality as well as the legal form.

Based on the revised framework, which was effective from 1 January 2011, the full structure of Falak Aviation Fund B.S.C. (c) has been consolidated line by line which has resulted in the recognition of ijarah assets (aircraft) amounting to US$ 286.6 million and the related term financing amounting to US$ 183.2 million. As a result, comparative amounts are not comparable in this regard.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Accounting convention (continued)

2.2.1 New and amended accounting standards, interpretations and framework (continued)

Financial accounting standard (FAS 25) "Investment in sukuk, shares and similar instruments"
The Group has adopted FAS 25 issued by AAOIFI which covers the recognition, measurement, presentation and disclosure of investments in sukuk, shares and similar investments that exhibit characteristics of debt and equity instruments made by Islamic Financial Institutions.

The adoption of this standard did not have any impact on the accounting policies, financial position or performance of the Group.

2.3 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary as at 31 December each year. A subsidiary is an entity over which the Bank has power to control, which is other than fiduciary in nature. The financial information of the subsidiary (including special purpose entities that the Group controls) is prepared using consistent accounting policies, with the exception of the carrying value of investments in ijarah assets which are fair valued by the subsidiary but carried at cost less depreciation and impairment at the consolidated level. Appropriate adjustments have been processed as required to ensure consistency with the Group's accounting policies.

A subsidiary is fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continues to be consolidated until the date that such control ceases. Control is achieved where the Group has the power, directly or indirectly, to govern the financial and operating policies of the entity so as to obtain benefits from its activities. Losses within a subsidiary are attributed to the non-controlling interest even if that results in a deficit balance. The results of a subsidiary acquired or disposed off during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate.

All intra-group balances, transactions, income and expenses have been eliminated in full.

Non-controlling interest represents the portion of net income and net assets not held, directly or indirectly, by the Group and are presented separately in the consolidated statement of income and within owners' equity in the consolidated statement of financial position, separately from parent shareholders' equity.

The following is the Group's significant subsidiary as at 31 December 2011:

Name of subsidiary	*Country of incorporation*	*Equity interest*
Falak Aviation Fund B.S.C. (c)	Kingdom of Bahrain	86%

The Group had the following significant subsidiaries as at 31 December 2010:

Falak Aviation Fund B.S.C. (c)	Kingdom of Bahrain	86%
BWA UK Acquisition Company Limited	United Kingdom	85%

2.4 Cash and cash equivalents

Cash and cash equivalents as referred to in the consolidated statement of cash flows comprise cash and balances with banks and due from banks and financial institutions with original maturities of less than ninety days.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 Due from banks and financial institutions

Due from banks and financial institutions comprise commodity murabaha receivables and wakala receivables. Commodity murabaha receivables are stated net of deferred profits and provision for impairment, if any. Wakala receivables are stated at cost less provision for impairment, if any.

Murabaha receivables are sales on deferred terms. The Bank arranges a murabaha transaction by buying a commodity (which represents the object of the murabaha) and then resells this commodity to the Murabeh (beneficiary) after computing a margin of profit over cost. The sale price (cost plus the profit margin) is repaid in installments by the Murabeh over the agreed period.

2.6 Non-trading investments

These are classified as investments designated at fair value through equity.

Initial recognition

All investments are recognised on the acquisition date and are recognised initially at their fair value plus transaction costs.

Re-measurement to fair value

Investments designated at fair through equity are remeasured at fair value and the resultant fair value gain or loss is directly reported in equity under 'investments fair value reserve' until the investment is sold, realised or deemed to be impaired, at which time the realised gain or loss is reported in the consolidated statement of income.

The losses arising from impairment of such investments are recognised in the consolidated statement of income in "impairment losses" and removed from the investment fair value reserve. Impairment losses recognised in the consolidated statement of income for an equity instrument classified as fair value through equity are not reversed through the consolidated statement of income.

2.7 General provision

The Group maintains a general provision to reflect potential losses that may occur as a result of currently unidentifiable risks in relation to its investments. The amount reflects estimated losses affecting these investments attributable to unknown events that may have already occurred at the date of the consolidated financial statements, and not estimated losses attributable to future events. These provisions are reversed through the consolidated statement of income, if the balance exceeds the required level.

2.8 Investments in leases

Investments in leases are initially recognised at cost, being the fair value of consideration paid, and subsequently carried at cost less provision for impairment in value. Initial direct costs incurred in negotiating aviation lease arrangements are added to the carrying amount of the investment.

2.9 Investment in ijarah assets

Investment in ijarah assets are stated at cost less accumulated depreciation and accumulated impairment at the consolidated level. Changes in the expected useful life are accounted for by changing the depreciation period or method, as appropriate, and treated as changes in accounting estimates.

Depreciation is calculated using the straight-line method to write down the cost of ijarah assets to their residual values over their lease terms.

Ijarah assets are derecognised on disposal or when no future economic benefits are expected from their use. Any gain or loss arising on derecognition of the ijarah asset (calculated as the difference between the net disposal proceeds and the carrying amount of the ijarah asset) is recognised in the consolidated statement of income in the year the asset is derecognised.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.10 Net assets of disposal group classified as held for sale

Net assets of disposal group classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell. Net assets of disposal group are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of reclassification.

2.11 Investment property

Investment property is held to earn rentals or for capital appreciation. It is initially recorded at cost, being the fair value of the consideration, including acquisition charges associated with the property.

Subsequent to initial recognition, investment property is remeasured at fair value and changes in fair value are recognised in the consolidated statement of income as unrealised gain / loss on revaluation of investment property. The fair value of the investment property is determined based on valuations made by independent valuers.

In accordance with AAOIFI unrealised gains are appropriated to an "investment fair value reserve" in equity and are transferred to retained earnings only when realised.

2.12 Goodwill and intangible assets

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually, or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to the cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units.

Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash generating unit level, as appropriate and when circumstances indicate that the carrying value may be impaired.

2.13 Property and equipment

Property and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Depreciation is provided on straight line method at rates intended to write-off the cost of the assets over their estimated useful life.

Freehold land is not depreciated. The estimated useful lives of the assets for the calculation of depreciation are as follows:

Buildings	20 years
Others	3-5 years

Expenditure for maintenance and repairs is expensed as incurred.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.13 Property and equipment (continued)

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of income in the year the asset is derecognised.

The residual values, useful lives and methods of depreciation for property and equipment are reviewed, and adjusted if appropriate, at each financial year end.

2.14 Inventories

Inventories are valued at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

2.15 Due to banks and financial institutions

Amounts due to banks and financial institutions are initially recognised at cost, being the fair value of consideration received plus accrued profit. Subsequently, they are carried at amortised cost less amounts repaid.

2.16 Deferred tax

Deferred tax is provided using the liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax relating to items recognised directly in equity are recognised in equity and not in the consolidated statement of income.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

2.17 Recognition of income and expenses

Rental income from investments in ijarah assets
Rental income from investments in ijarah assets are recognised on the basis of contractual amounts receivable on a time apportioned basis.

Rental income and rental expense on investments in leases
Rental income and rental expense on investments in leases are recognised on the basis of contractual amounts receivable / payable on a time apportioned basis.

Revenue on sale of goods
Revenue from the sale of goods is recognised when the goods are physically delivered to the customer and is stated net of taxes and trade discounts.

Profit on amounts due from banks and financial institutions
Profit on amounts due from banks and financial institutions is recognised on a time apportioned basis over the period of the contract based on the principal amounts outstanding and the profit agreed with clients.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.17 Recognition of income and expenses (continued)

Dividends
Dividend revenue is recognised when the Group's right to receive the dividend is established.

Fee income
Fee income is recognised when earned.

Taxation
There is no taxation in the Kingdom of Bahrain. Taxation on foreign operations is provided in accordance with fiscal regulations of the respective countries in which the subsidiaries operate.

2.18 Derecognition of financial instruments

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

(i) the right to receive cash flows from the asset has expired;

(ii) the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement; or

(iii) the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

2.19 Foreign currencies

Transactions in foreign currencies are initially recorded at the functional currency rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency spot rate of exchange ruling at the consolidated statement of financial position date. All differences are taken to the consolidated statement of income. Non monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions.

Assets (including goodwill) and liabilities of foreign operations are translated at the exchange rates prevailing at the statement of financial position date. Income and expense items are translated at average exchange rates for the relevant year. All resulting exchange differences are taken directly to equity.

On disposal of a foreign operation, the component of equity relating to that particular foreign operation is recognised in the consolidated statement of income.

2.20 Significant accounting judgements and estimates

The preparation of the consolidated financial statements requires management to exercise judgement and make estimates that affect the amounts reported in the consolidated financial statements. The most significant use of judgement and estimates are as follows:

Going concern
The Group's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future. Furthermore, the Board of Directors is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on a going concern basis.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.20 Significant accounting judgements and estimates (continued)

Fair value of unquoted investments at fair value through equity
Where the fair value of the Group's investment portfolio cannot be derived from an active market, they are determined using a variety of valuation techniques. These techniques rely on market observable data where possible. Judgement by management is required to establish fair values through the use of appropriate valuation models. The judgements include consideration of comparable assets, discount rates and the assumptions used to forecast cash flows.

Fair value of investment property
The fair value of investment property is determined by independent real estate valuation experts based on input from management and using market observable data, where possible. This involves judgement by management as to the comparable assets, discount rates and cash flows.

2.21 Impairment
The Group assesses at each statement of financial position date whether there is objective evidence that a specific asset or a group of assets may be impaired. An asset or a group of assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred “loss event”) and that loss event(s) have an impact on the estimated future cash flows of the asset or the group of the assets that can be reliably estimated.

The Group treats non trading 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. The determination of what is "significant" or "prolonged" requires considerable judgment.

The Group assesses at each reporting date, or more frequently if events or changes in circumstances indicate so, whether the carrying value of investments in ijarah assets may be impaired. If any such indication exists, the Group makes an estimate of the recoverable amount of each asset in the portfolio individually. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and any impairment loss is recognised in the consolidated statement of income.

2.22 Employees' end of service benefits
The Bank provides end of service benefits to its employees in accordance with the requirement of the Bahrain Labour Law. The entitlement to these benefits is based upon the employees’ final salary and length of service, subject to the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

With respect to its employees who are Bahraini nationals, the Bank makes contributions to the General Organisation for Social Insurance calculated as a percentage of the employees’ salaries in accordance with the relevant regulation. The Group’s obligations are limited to these contributions, which are expensed when due.

2.23 Determination of fair values
For investments traded in organised financial markets, fair value is determined by reference to quoted market bid prices at the close of business on the consolidated statement of financial position date.

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

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.24 Provisions

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

2.25 Offsetting financial instruments

Financial assets and financial liabilities are offset, and the net amount reported in the consolidated statement of financial position, if and only if there is a legally enforceable or religious right (as determined by Shari'a) to set off the recognised amounts and the Group intends to settle on a net basis.

2.26 Zakah

In the absence of appointment of the Bank to pay zakah on behalf of Shareholders, the responsibility of payment of zakah is on individual shareholders of the Group.

3 DISPOSAL OF AN INVESTMENT

During the year the Bank entered into a Master Sale Agreement and disposed off its 85% equity interest in an investment. The gain recognised by the Bank from the disposal amounted to US$ 76 million. The share of profit recognised on the investment up to the date of disposal amounted to US$ 1.335 million (December 2010 : US$ 7.153 million).

4 CASH AND BALANCES WITH BANKS

	2011	*2010*
	US$ '000	*US$ '000*
Balances with banks	**12,044**	18,484
Cash in hand	**1**	2
	12,045	18,486

5 DUE FROM BANKS AND FINANCIAL INSTITUTIONS

	2011	*2010*
	US$ '000	*US$ '000*
Commodity murabaha	**137,402**	11,503
Deferred income	**(142)**	(1)
	137,260	11,502
Wakala receivables	**60,011**	22,784
	197,271	34,286

6 NON-TRADING INVESTMENTS

	2011	*2010*
	US$ '000	*US$ '000*
Investments designated at fair value through equity		
Quoted investment designated at fair value through equity (note 6.1)	**1,465**	1,906
Unquoted investments designated at fair value through equity	**20,633**	21,121
Specific provision	**(3,346)**	(1,533)
Unquoted investments designated at fair value through equity	**17,287**	19,588
	18,752	21,494

6.1 This represents an investment quoted on the Kuwait Stock Exchange.

7 INVESTMENTS IN LEASES

	2011 US$ '000	2010 US$ '000
Falak Lease One Limited	-	12,305
Falak Lease Two Limited	-	12,306
Falak Lease Three Limited	-	13,375
Falak Lease Four Limited	-	15,264
Falak Lease Seven Limited	-	17,309
Falak Lease Eight Limited	-	12,500
Falak Lease Nine Limited	-	3,130
Falak Lease Ten Limited	-	2,884
Falak Lease Eleven Limited	-	12,317
	-	101,390
General provision	-	(8,000)
	-	93,390

8 INVESTMENTS IN IJARAH ASSETS

	Cost at 1 January 2011 US$ '000	Depreciation charge US$ '000	Net book value at 31 December 2011 US$ '000	Net book value at 31 December 2010 US$ '000
Falak Fin One Limited	39,739	1,484	38,255	-
Falak Fin Two Limited	40,042	1,404	38,638	-
Falak Fin Three Limited	42,693	1,748	40,945	-
Falak Fin Four Limited	36,599	1,619	34,980	-
Falak Fin Seven Limited	44,359	2,180	42,179	-
Falak Fin Eight Limited	32,848	3,077	29,771	-
Falak Fin Nine Limited	5,046	1,631	3,415	-
Falak Fin Ten Limited	5,526	1,438	4,088	-
Falak Fin Eleven Limited	37,752	1,426	36,326	-
	284,604	16,007	268,597	-
General provision			(8,000)	-
			260,597	-

9 NET ASSETS OF DISPOSAL GROUP CLASSIFIED AS HELD FOR SALE

The disposal group is a company incorporated in the Cayman Islands which has a stake of 92.02% in a Danish operator that is a global leader in the provision of systems and solutions for filling and reconditioning of liquefied petroleum gas cylinders. As at 31 December 2011, the Group has retained a 21.5% stake in this Danish company and management remains committed to sell the investment and is actively marketing at a price that is reasonable. As at 31 December 2011, the total assets and liabilities amounted to US$ 91,231 thousand and US$ 29,824 thousand respectively (31 December 2010: US$ 46,260 thousand and US$ 29,789 thousand respectively).

10 INVESTMENT PROPERTY

	2011	*2010*
	US$ '000	*US$ '000*
Opening carrying value	**10,476**	11,454
Unrealised loss on investment property	**-**	(978)
Closing carrying value	**10,476**	10,476

The investment property represents land in the Kingdom of Bahrain. It is stated at fair value, determined based on valuations performed by three independent professional valuers as at 31 December 2011 and 31 December 2010. These valuers are industry specialists in valuing these types of investment properties.

11 GOODWILL AND INTANGIBLE ASSETS

	2011	*2010*
	US$ '000	*US$ '000*
Goodwill	**-**	156,217
Intangible assets	**-**	14,077
Amortised during the year (note 17)	**-**	(5,088)
	-	8,989
	-	165,206

12 OTHER ASSETS

	2011	*2010*
	US$ '000	*US$ '000*
Trade receivables	**-**	20,738
Deferred tax asset	**-**	9,478
Inventories	**-**	11,848
Other assets	**6,017**	7,780
	6,017	49,844

13 PROPERTY AND EQUIPMENT

	Freehold land US$ '000	*Building US$ '000*	*Others US$ '000*	*Total US$ '000*
Cost				
At 1 January 2011	4,316	4,079	5,343	13,738
On disposal of subsidiary	(1,154)	-	-	(1,154)
Additions	-	-	11	11
Disposals	-	-	(13)	(13)
At 31 December 2011	**3,162**	**4,079**	**5,341**	**12,582**
Accumulated depreciation				
At 1 January 2011	-	832	3,316	4,148
Charge for the year	-	204	1,229	1,433
Disposals	-	-	(7)	(7)
At 31 December 2011	**-**	**1,036**	**4,538**	**5,574**
Net book value				
At 31 December 2011	**3,162**	**3,043**	**803**	**7,008**
At 31 December 2010	4,316	3,247	2,027	9,590

14 TERM FINANCING

	Total 2011 US$ '000	*Total 2010 US$ '000*
Falak Fin One Limited	**22,752**	-
Falak Fin Two Limited	**22,962**	-
Falak Fin Three Limited	**25,358**	-
Falak Fin Four Limited	**19,362**	-
Falak Fin Seven Limited	**23,837**	-
Falak Fin Eight Limited	**21,861**	-
Falak Fin Nine Limited	**3,013**	-
Falak Fin Ten Limited	**3,013**	-
Falak Fin Eleven Limited	**21,946**	-
	164,104	-

The above financing has been obtained to purchase ijarah assets carries profit rates of between 3.3% and 6.8%, and matures between 2013 and 2015.

15 OTHER LIABILITIES

	2011 US$ '000	*2010 US$ '000*
Trade payables	**-**	8,167
Accrued expenses	**6,099**	3,637
Unearned rental income	**1,423**	912
Provision for employees end of service benefits	**1,089**	843
Legal and professional fees payable related to investment in leases	**1,033**	676
Rental expenses payable	**-**	670
Other liabilities	**10,000**	550
	19,644	15,455

15 OTHER LIABILITIES (continued)

The movement in provision for employees end of service benefits during the year is as follows:

	2011 US$ '000	*2010 US$ '000*
Opening balance	**843**	737
Charge for the year	**246**	332
Utilised and paid during the year	**-**	(226)
Closing balance	**1,089**	843

16 OWNERS' EQUITY

16.1 Share capital

	2011 US$ '000	*2010 US$ '000*
Authorised: 2,500,000,000 ordinary shares of US$ 1 each	**2,500,000**	2,500,000
Issued and fully paid up: 291,286,000 ordinary shares of US$ 1 each	**291,286**	291,286

16.2 Statutory reserve

In accordance with the Bahrain Commercial Companies Law ("BCCL") and the Bank's articles of association, 10% of the net income for the year is transferred to the statutory reserve until such time as the reserve reaches 50% of the Bank's paid-up share capital. This reserve is not distributable, but can be utilised as security for the purpose of distribution in such circumstances as stipulated in the BCCL and other applicable statutory regulations.

16.3 Investment fair value reserve

Unrealised gains on 'investment property' and certain 'investments carried at fair value through statement of income' as deemed appropriate by management, recorded in the consolidated statement of income are appropriated to the 'investment revaluation reserve' in equity and are not available for distribution. Upon disposal of such assets, the related cumulative gains or losses are transferred to retained earnings and become available for distribution.

16.4 Foreign currency translation reserve

The foreign currency translation reserve represents the net foreign exchange gain (loss) arising from translating the consolidated financial statements of the Group's quoted investment from its functional currency into United States Dollars.

17 NET INCOME FROM NON-BANKING ACTIVITIES

	2011 US$ '000	*2010 US$ '000*
Revenue from sale of goods	**-**	100,717
Cost of goods sold	**-**	(64,744)
Gross Profit	**-**	35,973
Selling and distribution expenses	**-**	(4,564)
Administrative expenses	**-**	(11,398)
Amortisation of intangible assets	**-**	(5,088)
Finance cost	**-**	(5,165)
Taxation	**-**	(2,605)
Total expenses from non-banking activities	**-**	(28,820)
Net income from non-banking activities	**-**	7,153

18 INCOME FROM NON-TRADING INVESTMENTS

	2011	*2010*
	US$ '000	*US$ '000*
Gain on disposal of investment designated at fair value through equity	**-**	2,209
Dividend income	**126**	-
	126	2,209

19 GENERAL AND ADMINISTRATION EXPENSES

	2011	*2010*
	US$ '000	*US$ '000*
Legal and professional	**1,241**	1,228
Rent and maintenance	**242**	403
Communication charges	**244**	260
Board of directors and committees meetings' expenses and attendance allowances	**120**	120
Marketing and advertisement	**29**	85
Travel expenses	**61**	41
Other expenses (including proposed board remuneration)	**1,560**	883
	3,497	3,020

20 PROVISIONS

	2011		
	Specific		***General***
	Non-trading Investments	***Other investments***	
	US$ '000	***US$ '000***	***US$ '000***
Balance at beginning of the year	**1,346**	**10,000**	**8,000**
Write back of provisions		**(10,000)**	**-**
New provisions made	**2,000**	**-**	**10,000**
Balance at the end of the year	**3,346**	**-**	**18,000**

	2010		
	Specific		*General*
	Non-trading Investments	*Other investments*	
	US$ '000	*US$ '000*	*US$ '000*
Balance at beginning of the year	3,296	10,000	8,000
Write back of provisions	(1,950)	-	-
New provisions made	-	-	-
Balance at the end of the year	1,346	10,000	8,000

21 CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the consolidated statement of cash flows comprise the following consolidated statement of financial position amounts:

	2011	*2010*
	US$ '000	*US$ '000*
Cash and balances with banks	**12,045**	18,486
Due from banks and financial institutions (original maturity within 90 days)	**197,271**	34,286
	209,316	52,772

22 FAIR VALUE OF FINANCIAL INSTRUMENTS

The Group uses the following hierarchy for determining and disclosing financial assets by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The Group's quoted investment designated at fair vale through equity qualifies for disclosure under Level 1 and its carrying value as at 31 December 2011 is US$ 1,465 thousand (31 December 2010: US$ 1,906 thousand). The Group does not have financial instruments qualifying for Level 2 or Level 3 disclosure. The other investments designated at fair vale through equity amounting to US$ 19,287 thousand (31 December 2010: US$ 19,588 thousand) are carried at cost less impairment.

23 CAPITAL MANAGEMENT

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 CBB.

The primary objectives of the Bank's capital management are to ensure that the Group complies with externally imposed capital requirements and maintains healthy capital ratios in order to support its business and maximise shareholder value.

Regulatory capital consists of Tier 1 Capital, which comprises principally of share capital, statutory reserve, accumulated losses and non controlling interest. The other component of regulatory capital, Tier 2 Capital, consists of investment fair value reserves. Certain adjustments are made to these balances as prescribed by the CBB. Risk-weighted assets are calculated in accordance with the prudential rules laid down by the CBB.

The Bank maintains an actively managed capital base to cover risks inherent in the business.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue new capital. No changes were made in the objectives, policies and processes from the previous

23 CAPITAL MANAGEMENT (continued)

Regulatory capital

	Note	***2011 US$'000***	*2010 US$'000*
Tier 1 capital	23.1	**311,285**	250,979
Tier 2 capital		**(31,155)**	(32,260)
Total capital base (a)		**280,130**	218,719
Risk weighted assets (b)	23.3	**455,509**	358,150
Capital adequacy (a/b x 100)		**61.50%**	61.07%
Minimum requirement		**12.0%**	12.0%

23.1 Tier 1 Capital

	2011 US$'000	*2010 US$'000*
Share capital	**291,286**	291,286
Statutory reserve	**8,590**	2,557
Other reserve	**419**	1,657
Accumulated gains / (losses)	**26,896**	(27,396)
Non-controlling interest	**15,857**	15,293
Core Tier 1 Capital	**343,048**	283,397
Deductions	**(31,763)**	(32,418)
Tier 1 Capital	**311,285**	250,979
Negative balance of Tier 2	**(31,155)**	(32,260)
Tier 1 Capital net of negative Tier 2 Capital	**280,130**	218,719

23.2 Tier 2 Capital

	2011 US$ '000	*2010 US$ '000*
Investments designated at fair vale thorugh equity (45%)	**189**	158
Core Tier 2 Capital	**189**	158
Deductions	**(31,344)**	(32,418)
Tier 2 Capital	**(31,155)**	(32,260)

23.3 Risk weighted assets

	2011 US$ ‘000	*2010 US$ ‘000*
Credit risk weighted assets	**296,478**	309,315
Market risk weighted assets	**35,838**	23,438
Operational risk weighted assets	**123,193**	25,397
	455,509	358,150

Credit risk weighted assets

The Bank uses the standardised approach, which requires banks to use external credit ratings to combine them into categories to which standardised risk weightings are applied. For regulatory purposes, credit risk-weighted assets include investments and receivables.

23 CAPITAL MANAGEMENT (continued)

23.3 Risk weighted assets (continued)

Market risk weighted assets

The Bank does not maintain a trading book and, as a result, market risk-weighted assets result from the net foreign currency positions of the Group.

Operational risk weighted assets

In calculating operational risk-weighted assets, the Bank uses the basic indicator approach which calculates operational risk-weighted assets as a proportion of the average of three years' revenues.

23.4 Tier 1 Capital Adequacy Ratio

	2011	*2010*
Capital Adequacy on Tier 1 Capital	**68.34%**	70.08%

24 SEGMENTAL INFORMATION

For management purposes, the Group is organised into business units based on the nature of their operations and services. The Group has two reportable segments being geographical segment and industrial segment.

Geographical segment

The geographical segment is a distinguishable component that is engaged in providing an individual product or service or a group of related products or services within a particular economic environment which may have risks and returns that may be different from the components operating in other economic

Industrial segment

The industrial segment is a distinguishable component that is engaged in providing an individual product or service or a group of related product or services which may have risks and returns that may be different from those of other business segments.

	2011		*2010*	
	Assets	***Liabilities***	*Assets*	*Liabilities*
	US$'000	***US$'000***	*US$'000*	*US$'000*
Geographical segment:				
Bahrain	**246,320**	**16,170**	83,649	16,096
Europe	**135,571**	**166,490**	237,456	97,952
Others	**144,905**	**1,088**	96,620	2,745
	526,796	**183,748**	417,725	116,793
Industrial segment:				
Banking and financial institutions	**211,489**	**166,104**	54,945	101,337
Aviation	**262,255**	**2,772**	95,816	1,582
Real estate	**21,380**	**-**	23,664	-
Utilities	**6,380**	**-**	6,397	-
Manufacturing	**16,163**	**-**	224,902	11,587
Others	**9,129**	**14,872**	12,001	2,287
	526,796	**183,748**	417,725	116,793

24 SEGMENTAL INFORMATION (continued)

Segment total operating income, net operating expenses and net income / (loss) were as follows:

	2011			*2010*		
	Total operating income US$'000	**Net operating expenses US$'000**	**Net income / (loss) US$'000**	*Total operating income US$'000*	*Net operating expenses US$'000*	*Net income (loss) US$'000*
Geographical segment:						
Bahrain	**13,142**	**(30,471)**	**(17,329)**	4,819	(11,248)	(6,429)
Europe	**88,456**	**(9,945)**	**78,511**	35,973	(28,820)	7,153
Others	**1,620**	**(1,426)**	**194**	34,313	(27,791)	6,522
	103,218	**(41,842)**	**61,376**	75,105	(67,859)	7,246
Industrial segment:						
Banking and financial institutions	**1,084**	**(23,835)**	**(22,751)**	2,195	(10,270)	(8,075)
Aviation	**25,454**	**(16,007)**	**9,447**	34,313	(27,791)	6,522
Real estate	**-**	**(2,000)**	**(2,000)**	-	(978)	(978)
Utilities	**-**	**-**	**-**	1,950	-	1,950
Manufacturing	**76,680**	**-**	**76,680**	36,569	(28,820)	7,749
Others	**-**	**-**	**-**	78	-	78
	103,218	**(41,842)**	**61,376**	75,105	(67,859)	7,246

25 RELATED PARTIES

Related parties comprise shareholders of the Group, directors of the Group, Shari'a Supervisory Board members, entities owned or controlled, jointly controlled or significantly influenced by them and companies affiliated by virtue of shareholding in common with that of the Group. These transactions have been carried out on an arm's length basis in manner similar to transactions with a third party.

Balances with related parties included in the consolidated statement of financial position are as follows:

	2011				*2010*
	Shareholders	**Directors**	**Others**	**Total**	*Total*
Assets					
Quoted investment designated at fair vale through equity	**-**	**-**	**-**	**-**	1,906

The transactions with related parties included in the consolidated statement of income are as follows:

	Shareholders	**Directors**	**Others**	**Total**	*Total*
Income					
Fee income	**115**	-	-	**115**	108
Gain on disposal of property and equipment	-	-	-	**-**	78
Expenses					
Board of directors and committees meetings' expenses and attendance allowances	-	69	-	**69**	69
Shari'a Supervisory Board meetings' expenses and attendance allowances	-	**51**		**51**	51
Fees expense	**1**	-	-	**1**	23

25 RELATED PARTIES (continued)

Key management personnel are those that possess significant decision making and direction setting responsibilities within the Bank. Staff costs attributable to key management personnel of the Bank is as follows:

	2011	*2010*
	US$'000	*US$'000*
Short term employee costs	**1,315**	1,958
Termination costs	**205**	265
	1,520	2,223

26 COMMITMENTS

Commitments generally have fixed expiration dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash flow requirements.

The Bank has the following commitments.

	Less than 1 year	*1 to 5 years*	*Total*
	US$ '000	*US$ '000*	*US$ '000*
At 31 December 2011			
Capital and other commitments	**525**	**-**	**525**
	525	**-**	**525**
At 31 December 2010			
Capital and other commitments	749	3	752
	749	3	752

27 SHARI'A SUPERVISORY BOARD

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

28 RISK MANAGEMENT

Risk management plays a critical role in the Group’s decision making process. It is managed through a Management Investment Committee and the Asset Liability and Risk Management Committee. Both committees comprise of senior management drawn from key areas of the Group in implementing risk strategy and policies, monitoring and managing the key risks to which the bank is exposed. The Group is exposed to credit risk, concentration risk, profit rate risk, liquidity risk, equity price risk, foreign currency risk and operational risk.

Although management responsible for the key areas of the Bank are accountable for the risks that arise within their respective areas, the Risk Management Department independently identifies, measures, monitors and recommends appropriate steps to manage each type of risk. The Risk Management Department has independent access to the Board of Directors and updates them on the overall risk profile of the Group on a regular basis.

28.1 Risk management structure

Board of Directors
The Board of Directors is ultimately responsible for the overall risk management approach and for approving risk strategies, risk policies and procedures.

Shari'a Supervisory Board
The Shari'a Supervisory Board reviews the principles and contracts relating to the transactions conducted by the Bank to judge whether it followed the principles of the Islamic Shari'a and specific fatwas, rulings and guidelines issued.

Executive Committee
The Executive Committee of the Board considers and approves proposals to purchase and sell individual investments up to the limit accorded by the Board.

Management Investment Committee
One of the key risks the Group is exposed to, is the underwriting of investments and proprietary investments. It is the role of the Management Investment Committee to approve or disapprove such investments based on risks highlighted by the Risk Management Department and the relevant mitigating factors presented by the relevant business team.

Asset Liability and Risk Management Committee
The Asset Liability and Risk Management Committee’s responsibility is to manage all risks including liquidity, rate of return, credit, market and operational risks within the Policy framework of the Bank and regulatory requirements. It recommends liquidity limits and concentration limits to the Board of Directors.

Risk Management Department
The Risk Management Department is responsible for developing and implementing appropriate risk management strategies and methodologies for the Group. It ensures that there are adequate control procedures in place such that the risks exposed to are within the approved limits.

Risk management and reporting systems
The Risk Management Department is responsible for managing and monitoring risk exposures. The Risk Management Department measures risk through the use of risk models and provides reports to the Asset Liability and Risk Management Committee. Monitoring and controlling risks are managed through limits set by the Board. The Risk Management Department presents reports to the Board of Directors, Asset Liability and Risk Management Committee and other relevant departments as required. These reports include analysis of capital adequacy, credit exposure, investment exposure, and foreign currency exposures.

28 RISK MANAGEMENT (continued)

28.2 Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Group manages credit risk by setting limits for individual counterparties. Counterparty limits are set by the Board of Directors and monitored by the Risk Management Department and reviewed regularly.

The Group does not engage in commercial or retail banking. Its exposure to credit risk arises largely through placement of liquid funds in banks accounts, murabaha contracts, wakala contracts and receivables. The Group deploys excess funds in a conservative manner, targeting highly rated financial institutions locally and regionally.

Credit risk is managed by the Group through limits for each counterparty approved by the Board of Directors and monitored on a daily basis by the Risk Management Department. Any exception or deviation to the approved terms and conditions requires senior management approval and such exceptions are reported to the Board. The Group makes use of an internal rating system, covering a wide range of qualitative and quantitative factors, in assessing the creditworthiness of counterparties. The ratings generated by the internal rating system are compared, where applicable, against the ratings assigned by External Credit Assessment Institutions ["ECAI"] to ensure consistency between the ratings of the internal system and those of ECAI. ECAI considered by the Group are Standard and Poor's, Moody's and Fitch.

The Group does not have collateral for any of its credit risk exposures. In placing short-term funds with financial institutions the Group performs a credit analysis of each counterparty (including consideration of external credit rating if any), sets limits and monitors such limits.

The following table analyses the geographical and counterparty type concentrations of the Group's maximum exposure to credit risk:

(i) Maximum exposure to credit risk

	2011 ***US$'000***	*2010* *US$'000*
Balances with banks	**12,044**	18,484
Due from banks and financial institutions	**197,271**	34,286
Investments in leases	**-**	93,390
Other assets	**4,833**	37,996
	214,148	184,156

Exposures by geographical region

As at 31 December 2011:

	Bahrain US$'000	***Europe US$'000***	***Other GCC countries US$'000***	***Other Middle East & Asia US$'000***	***North America US$'000***	***Total US$'000***
Balances with banks	**1,563**	**4,959**	**58**	**-**	**5,464**	**12,044**
Due from banks and financial institutions	**112,259**	**-**	**85,012**	**-**	**-**	**197,271**
Other assets	**835**	**-**	**2,340**	**1,658**	**-**	**4,833**
	114,657	**4,959**	**87,410**	**1,658**	**5,464**	**214,148**

28 RISK MANAGEMENT (continued)

28.2 Credit risk (continued)

Exposures by geographical region

	Bahrain US$'000	*Europe US$'000*	*Other GCC countries US$'000*	*Other Middle East & Asia US$'000*	*North America US$'000*	*Total US$'000*
As at 31 December 2010:						
Balances with banks	644	10,014	333	1,398	6,095	18,484
Due from banks and financial institutions	20,584	-	13,702	-	-	34,286
Investments in leases	34,988	47,057	-	11,345	-	93,390
Other assets	1,381	24,593	1,794	4,623	5,605	37,996
	57,597	81,664	15,829	17,366	11,700	184,156

Exposure by industry:

As at 31 December 2011:

	Aviation US$'000	*Banking and finance US$'000*	*Manufacturing US$'000*	*Other US$'000*	*Total US$'000*
Balances with banks	**-**	**12,044**	**-**	**-**	**12,044**
Due from banks and financial institutions	**-**	**197,271**	**-**	**-**	**197,271**
Investments in leases		**-**	**-**	**-**	**-**
Other assets	**1,658**	**2,172**	**67**	**936**	**4,833**
	1,658	**211,487**	**67**	**936**	**214,148**

As at 31 December 2010:

	Aviation US$'000	*Banking and finance US$'000*	*Manufacturing US$'000*	*Other US$'000*	*Total US$'000*
Balances with banks	-	18,484	-	-	18,484
Due from banks and financial institutions	-	34,286	-	-	34,286
Investments in leases	93,390	-	-	-	93,390
Other assets	2,426	1,665	31,496	2,409	37,996
	95,816	54,435	31,496	2,409	184,156

28.3 Market Risk

Market risk is the risk that arises from fluctuations in market risk factors that include profit rate risk, currency risk and equity price risk and will have a negative impact on the Group income and/or will decrease the value of its portfolios.

Profit rate risk

Profit rate risk is combination of the rate of return risk and the risk of exposure due to the mismatch in the Group's profit-sensitive assets and liabilities caused by variations in the market reference rate, which would result in a decrease of the Group's net present value.

The Group currently has limited exposure to profit rate risk. The Group’s assets that are exposed to profit rate risk comprise of due from financial institutions and due to banks and financial institutions and have repricing dates no longer than three months. During 2011, a +/- 200bp change in the profit rate, with all other variables constant, would have resulted in a +/- US$ 1,778 thousand (31 December 2010: +/-200bp resulted in +/- US$ 349 thousand) impact on the consolidated statement of income.

28 RISK MANAGEMENT (continued)

28.3 Market risk (continued)

The following table indicates the effective profit rates on such financial instruments:

	2011	*2010*
Investments in leases	-	7.29%
Due from banks and financial institutions	**0.78%**	0.61%
Due to banks and financial institutions	**-**	1.50%

Currency risk
Currency risk represents fluctuations in exposures held by the Group in currencies other than the US$. The Group may engage, in the normal course of business, in transactions denominated in currencies other than its functional currency. The Bank risk management policy regulates such exposure by hedging currency exposures with Shari'a compliant instruments. Currency exposure is monitored daily by Risk Management Department and reported on a monthly basis to the Asset Liability and Risk Management Committee.

The Group has the following significant foreign currency exposures at the consolidated statement of financial position date:

		2011	
	Assets US$'000	***Liabilities US$'000***	***Net US$'000***
Danish Krone	**14,630**	**-**	**14,630**
Kuwaiti Dinars	**1,494**		**1,494**
Great Britain Pounds	**6,423**	**-**	**6,423**
Euro	**13,273**	**-**	**13,273**

		2010	
	Assets US$'000	*Liabilities US$'000*	*Net US$'000*
Danish Krone	14,953	-	14,953
Kuwaiti Dinars	1,943	-	1,943
Great Britain Pounds	6,454	-	6,454
Euro	15,039	(14,973)	66

The table below indicates the impact of reasonably possible changes in exchange rates on the Group's net foreign currency exposure. The impact has been calculated using the net foreign currency exposure as at the balance sheet date and calculating the impact of the change in exchange rate.

	Change in exchange rates (+/-) %	***Net income and equity (+/-) US$'000***
Danish Krone	**10**	**1,463**
Kuwaiti Dinars	**10**	**149**
Great Britain Pounds	**10**	**642**
Euro	**10**	**1,327**

Equity price risk
Equity price risk is the risk that the fair value of investments designated at fair vale thorugh equity decreases due to fluctuations in the respective stock market indices.

28 RISK MANAGEMENT (continued)

28.3 Market risk (continued)

Equity price risk (continued)
As at 31 December 2011 the Group had investments in quoted equities on the Kuwait Stock Exchange. The table below reflects the sensitivity of the investment portfolio to changes in these inputs. The sensitivity of trading investments is calculated by considering the impact of reasonably expected changes in the capitalisation rate.

	Change in equity price (+/-)	*Effect on net equity (+/-)*
	%	*US$'000*
Kuwait Stock Exchange	**10**	**147**

The Group also has unquoted investments carried at cost where the impact of changes in equity prices will only be reflected when the investment is sold or deemed to be impaired, when the consolidated statement of income will be impacted, or when a third party transaction in the investment gives a reliable indication of fair value which will be reflected in equity.

The total market risk weighted assets and regulatory capital requirements related to market risk are as follows:

	2011	*2010*
	US$ '000	*US$ '000*
Foreign exchange risk	**35,838**	23,438
Regulatory capital requirement (Multiple 12.5)	**2,867**	1,875

During the year, the maximum capital requirement as per Standardized Method was US$ 2.9 million on 31 December 2011 while the minimum capital requirement was US$ 1,909 on 30 September 2011.

28.4 Operational risk

Operational risk is the risk of loss arising from human error, fraud, and control or system failure which may cause legal, regulatory and financial loss. The Group has implemented a strong corporate governance framework and control mechanism to prevent such potential operational risks. The Bank's internal audit function performs regular independent audits of each critical area and reports to the Board Audit Committee on a regular basis.

The Group has in place an operational risk policy that set guidelines to manage the Group's exposure to loss and protects its assets and outlines the principles of the Group's operational risk management framework. This policy is supplemented by specific operational risk management procedures. The operational risk management framework provides directives associated with the operational risk in terms of identification, assessment, monitoring and reporting, mitigation and control of operational risks.

The policy also sets out the responsibility and accountability of all parties related to the operational risk represented by the Board of Directors, Audit Committee, Asset Liability and Risk Management Committee, Risk Management Department, staff, contractors and Internal Audit.

28 RISK MANAGEMENT (continued)

28.4 Operational risk (continued)

The Risk Appetite is defined by the Group as the amount of risk that is acceptable to the Group. The operational risk appetite is determined by Risk Management Department on an ongoing basis based on a bottom-up approach following discussion with other lines of business. Operational Risk Appetite is approved by the Asset Liability and Risk Management Committee, ratified by the Board and documented and communicated via the Board-approved policy. The Group adopts qualitative and quantitative criteria in measuring its risk appetite.

The Group, based on the operational risk management framework, has implemented a strong governance framework and control mechanism to manage this risk and reduce potential operational risks. The controls in place include segregation of duties, access controls, authorisation, approval and reconciliation procedures, staff education and appraisal processes.

The Group measures and allocates capital to its operational risk using the Basic Indicator Approach. The total operational risk weighted assets and regulatory capital requirements related to the operational risk are as follows:

	2011	*2010*
	US$ '000	*US$ '000*
Average gross income	**65,703**	13,545
Operational risk weighted assets	**123,193**	25,397
Regulatory capital requirement (at 12%)	**14,783**	3,048

29 SOCIAL RESPONSIBILITY

The Group discharges its social responsibilities through donations to charitable causes and organisations.

30 FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Group's financial instruments are not significantly different from their book values as at the consolidated statement of financial position date.

31 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

The Group has not received any income which was non shariah compliant as at 31 December 2011 (31 December 2010 nil).

Credit risk

(i) Maximum exposure

As at 31 December 2011:

	Gross funded credit exposures US$ '000	*Net funded credit exposures US$ '000*	*Credit risk weighted exposures US$ '000*	*Regulatory capital requirements US$ '000*
Investments	**304,455**	**242,585**	**221,998**	**26,640**
Due from banks and financial institutions				
Murabaha receivables	**137,260**	**137,260**	**30,453**	**3,654**
Wakala receivables	**60,011**	**60,011**	**25,504**	**3,060**
Other assets	**25,070**	**25,070**	**18,523**	**2,223**
	526,796	**464,926**	**296,478**	**35,577**

As at 31 December 2010:

Investments	247,681	182,655	284,955	34,195
Due from banks and financial institutions				
Murabaha receivables	11,502	11,502	3,651	438
Wakala receivables	22,784	7,811	1,562	187
Other assets	20,622	20,622	19,147	2,298
	302,589	222,590	309,315	37,118

The year-end credit exposure position as disclosed above is representative of the risk positions of the Group during the period and accordingly, the average gross exposures have not been disclosed. Under CBB prudential guidelines investment in a commercial entity is not consolidated.

(ii) Geographical region and counterparty

Net funded credit exposures by geographical region

As at 31 December 2011:

	Due from banks and financial institutions				
	Investment US$ '000	***Murabaha receivable US$ '000***	***Wakala receivables US$ '000***	***Other US$ '000***	***Total US$ '000***
Europe	**132,143**	**-**	**-**	**5,428**	**137,571**
Bahrain	**62,949**	**97,254**	**15,005**	**9,471**	**184,679**
Other GCC Countries	**1,235**	**40,006**	**45,006**	**2,398**	**88,645**
Other Middle East and Asia	**46,258**	**-**	**-**	**2,307**	**48,565**
North America	**-**	**-**	**-**	**5,466**	**5,466**
	242,585	**137,260**	**60,011**	**25,070**	**464,926**

As at 31 December 2010:

Europe	110,946	-	-	4,995	115,941
Bahrain	45,463	4,501	1,110	10,461	61,535
Other GCC Countries	1,713	7,001	6,701	1,860	17,275
Other Middle East and Asia	24,533	-	-	2,905	27,438
North America	-	-	-	401	401
	182,655	11,502	7,811	20,622	222,590

Credit risk (continued)

(ii) Geographical region and counterparty (continued)

Counterparty type:

Net funded credit exposures by counterparty:

As at 31 December 2011:

	Investment US$'000	***Murabaha receivable US$'000***	***Wakala receivables US$'000***	***Other US$'000***	***Total US$'000***
Investment in securities	**221,205**	**-**	**-**	**-**	**221,205**
Claims on banks	**-**	**137,260**	**60,011**	**12,044**	**209,315**
Holdings of real estate	**21,380**	**-**	**-**	**6,781**	**28,161**
Claims on corporates	**-**	**-**	**-**	**4,833**	**4,833**
Other assets	**-**	**-**	**-**	**1,412**	**1,412**
	242,585	**137,260**	**60,011**	**25,070**	**464,926**

Net funded credit exposures by counterparty

As at 31 December 2010:

	Investment US$'000	*Murabaha receivables US$'000*	*Wakala receivables US$'000*	*Other assets US$'000*	*Total US$'000*
Investment in securities	158,991	-	-	-	158,991
Claims on banks	-	11,502	7,811	4,680	23,993
Holdings of real estate	23,664	-	-	7,313	30,977
Claims on corporates				6,489	6,489
Other assets	-	-	-	2,140	2,140
	182,655	11,502	7,811	20,622	222,590

(iii) Analysis of exposure to credit risk by external credit ratings

No financial assets are past due or impaired. The table below analyses the Group's maximum credit exposure where the credit quality is reflected by Standard and Poor's, Moody's and Fitch credit ratings where relevant of the counterparties:

	2011 US$ '000	*2010 US$ '000*
Credit rating:		
AAA to AA-	**52,047**	14,144
A+ to A-	**107,272**	5,839
BBB+ to BBB-	**15,044**	1,570
BB+ to B-	**19,930**	2,376
Unrated	**270,633**	198,661
	464,926	222,590

Credit risk (continued)

(iv) Concentration risk

Concentration risk arises when a number of counterparties are engaged in similar business activities, or activities in the same geographical region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentration indicates relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location. The Group has established guidelines assigning limits for countries, industry, currencies etc.

The distribution of assets and liabilities by geographical region and industry sector was as follows:

	2011		*2010*	
	Assets	***Liabilities***	*Assets*	*Liabilities*
	US$'000	***US$'000***	*US$'000*	*US$'000*
Geographical region:				
Bahrain	**246,320**	**16,170**	76,507	16,713
Other Gulf Cooperation Council (GCC) Countries	**88,876**	**1,088**	17,468	211
Europe	**137,571**	**166,490**	180,775	1,110
Other Middle East and Asia	**48,564**		27,438	807
North America	**5,465**	**-**	401	-
	526,796	**183,748**	302,589	18,841

	2011		*2010*	
	Assets	***Liabilities***	*Assets*	*Liabilities*
	US$'000	***US$'000***	*US$'000*	*US$'000*
Industry sector:				
Banking and financial institutions	**211,489**	**166,104**	41,141	14,973
Aviation	**262,255**	**2,772**	95,815	1,582
Real estate	**21,380**	**-**	23,664	-
Utilities	**6,380**	**-**	6,397	-
Manufacturing	**16,163**	**-**	124,725	-
Services	**-**	**-**	3	-
Others	**9,129**	**14,872**	10,844	2,286
	526,796	**183,748**	302,589	18,841

Credit risk (continued)

(v) Large exposures

The Group follows the CBB's guidelines with respect to definition and measurement of large exposures at the consolidated level as stipulated in the CBB Rulebook for Islamic Banks.

As at 31 December 2011:

	Large exposure (banks) US$ '000	***% of exposure to capital***		***Large exposure (non - banks) US$ '000***	***% of exposure to capital***
Bank A	**30,525**	***8.7%***	Counterparty A	**114,113**	***32.6%***
Bank B	**30,004**	***8.6%***	Counterparty B	**40,120**	***11.5%***
Bank C	**20,003**	***5.7%***	Counterparty C	**35,354**	***10.1%***
Bank D	**20,003**	***5.7%***	Counterparty D	**33,776**	***9.7%***
Bank E	**16,507**	***4.7%***	Counterparty E	**30,205**	***8.6%***
Bank F	**15,022**	***4.3%***	Counterparty F	**14,631**	***4.2%***
Bank G	**15,010**	***4.3%***	Counterparty G	**10,907**	***3.1%***
Bank H	**15,003**	***4.3%***	Counterparty H	**6,380**	***1.8%***
Bank I	**10,007**	***2.9%***	Counterparty I	**1,235**	***0.4%***
Bank J	**10,006**	***2.9%***			
Bank K	**10,004**	***2.9%***			
Bank L	**5,504**	***1.6%***			
Bank M	**5,493**	***1.6%***			
Bank N	**3,175**	***0.9%***			
Bank O	**1,714**	***0.5%***			
Bank P	**1,248**	***0.4%***			

As at 31 December 2010:

	Large exposure (banks) US$ '000	*% of exposure to capital*		*Large exposure (non - banks) US$ '000*	*% of exposure to capital*
Bank A	7,001	*2.5%*	Counterparty A	107,369	*37.9%*
Bank B	6,701	*2.4%*	Counterparty B	37,985	*13.4%*
Bank C	4,500	*1.6%*	Counterparty C	17,309	*6.1%*
Bank D	2,376	*0.8%*	Counterparty D	15,264	*5.4%*
Bank E	1,099	*0.4%*	Counterparty E	14,953	*5.3%*
Bank F	1,052	*0.4%*	Counterparty F	13,188	*4.7%*
			Counterparty G	12,500	*4.4%*
			Counterparty H	12,317	*4.3%*
			Counterparty I	6,397	*2.3%*
			Counterparty J	3,130	*1.1%*
			Counterparty K	2,884	*1.0%*
			Counterparty L	1,398	*0.5%*

Credit risk (continued)

(vi) Liquidity risk

Liquidity risk is inherent in all banking institutions and arises mainly from mismatching of timing in the cash flows and can be affected by a range of institution specific and market-wide events including credit events, mergers and acquisitions and economic shocks. Liquidity is monitored regularly by the Asset Liability and Risk Management Committee ["AL&RMCO"].

The Group policies and procedures lay out guidelines that will optimise use of excess liquidity and ensure availability of funds to meet the Group's obligations when they fall due. The Group's funding guidelines include: 1) The mobilisation and placement of short term funds through placements and murabaha transactions by Treasury, 2) All funding objectives should be aligned to the strategic objectives of the Bank, 3) The composition, characteristics and diversification of the Bank's funding structure will be monitored by AL&RMCO and executed by Treasury, Treasury will maintain the counterparty relationships to obtain the necessary lines of funding, 4) AL&RMCO will monitor the concentration of funding sources across products and counterparties and effect measures to mitigate undue concentrations, 5) Treasury will implement the deals within the approved guidelines, including the approved products and the counterparties.

The maturity profile of assets and liabilities as at 31 December 2011 based on contractual maturity is as follows:

	Upto 1 month US$'000	*1 to 3 months US$'000*	*3 to 6 months US$'000*	*6 months to 1 year US$'000*	*Sub-total 1 year US$'000*	*1 to 3 years US$'000*	*Over 3 years US$'000*	*Sub-total over 1 year US$'000*	*No fixed maturity US$'000*	*Total US$'000*
Assets										
Cash and balances with banks	**12,045**	**-**	**-**	**-**	**12,045**	**-**	**-**	**-**	**-**	**12,045**
Due from banks and financial institutions	**93,252**	**104,019**	**-**	**-**	**197,271**	**-**	**-**	**-**	**-**	**197,271**
Non-trading investments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**18,752**	**18,752**
Investments in leases		**-**	**-**	**-**	**-**			**-**	**260,597**	**260,597**
Net assets of disposal group classified as held for sale	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**14,630**	**14,630**
Investment property	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**10,476**	**10,476**
Other assets	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**6,017**	**6,017**
Property and equipment	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**7,008**	**7,008**
	105,297	**104,019**	**-**	**-**	**209,316**	**-**	**-**	**-**	**317,480**	**526,796**
Liabilities										
Term financing	**6,026**	**-**	**-**	**-**	**6,026**	**45,714**	**112,364**	**158,078**	**-**	**164,104**
Due to banks and					**-**					
financial institutions	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Other liabilities	**5,039**	**-**	**-**	**-**	**5,039**	**-**	**-**	**-**	**14,605**	**19,644**
	11,065	**-**	**-**	**-**	**11,065**	**45,714**	**112,364**	**158,078**	**14,605**	**183,748**
Net	**94,232**	**104,019**	**-**	**-**	**198,251**	**(45,714)**	**(112,364)**	**(158,078)**	**302,875**	**343,048**

ADDITIONAL DISCLOSURES FOR CREDIT RISK IN COMPLIANCE WITH PUBLIC DISCLOSURE MODULE OF THE CENTRAL BANK OF BAHRAIN

Appendix to Consolidated Financial Statements for the Year Ended 31 December 2011

Credit risk (continued)

(vi) Liquidity risk

The maturity profile of assets and liabilities as at 31 December 2010 based on contractual maturity is as follows:

	Upto 1 month US$'000	*1 to 3 months US$'000*	*3 to 6 months US$'000*	*6 months to 1 year US$'000*	*Sub-total 1 year US$'000*	*1 to 3 years US$'000*	*Over 3 years US$'000*	*Sub-total over 1 year US$'000*	*No fixed maturity US$'000*	*Total US$'000*
Assets										
Cash and balances with banks	4,682	-	-	-	4,682	-	-	-	-	4,682
Due from banks and financial institutions	18,262	16,024	-	-	34,286	-	-	-	-	34,286
Non-trading investments	-	-	-	-	-	-	-	-	21,494	21,494
Investments in leases	5,540	-	-	-	5,540	22,669	65,181	87,850	-	93,390
Net assets of disposal group classified as held for sale	-	-	-	-	-	-	-	-	122,321	122,321
Investment property	-	-	-	-	-	-	-	-	10,476	10,476
Other assets	-	-	-	-	-	-	-	-	7,504	7,504
Property and equipment	-	-	-	-	-	-	-	-	8,436	8,436
	28,484	16,024	-	-	44,508	22,669	65,181	87,850	170,231	302,589
Liabilities										
Due to banks and financial institutions	-	14,973	-	-	14,973	-	-	-	-	14,973
Other liabilities	-	-	-	-	-	-	-	-	3,868	3,868
	-	14,973	-	-	14,973	-	-	-	3,868	18,841
Net	28,484	1,051	-	-	29,535	22,669	65,181	87,850	166,363	283,748

ADDITIONAL DISCLOSURES FOR CREDIT RISK IN COMPLIANCE WITH PUBLIC DISCLOSURE MODULE OF THE CENTRAL BANK OF BAHRAIN

Appendix to Consolidated Financial Statements for the Year Ended 31 December 2011

Credit risk (continued)

Equity Gains or Losses in Banking book

	2011	*2010*
	US$ '000	*US$ '000*
Cumulative realized loss arising from sales or liquidations in the reporting period	**-**	-
Cumulative realized gain arising from sales or liquidations in the reporting period	**76,048**	2,209
Total unrealized losses recognized in the statement of financial position but not through statement of income	**-**	-
Total unrealized gains recognized in the statement of financial position but not through statement of income	**419**	1,657
Total unrealized losses included in Tier 1 capital	**-**	-
Total unrealized gains included in Tier 1 capital	**-**	-
Unrealized gains included in Tier 2 capital	**189**	158