

BMB INVESTMENT BANK

ANNUAL REPORT
FOR THE YEAR ENDED
31 DECEMBER 2007

The legal name of BMB Investment Bank is Bahrain Middle East Bank (B.S.C.)

BMB INVESTMENT BANK

A brief history of Bahrain Middle East Bank (B.S.C.)

BMB was established as an exempt joint stock company on 21 March 1982 with Commercial Register Number 12266 and operates under a licence granted by the Central Bank of Bahrain.

The Bank is principally engaged in investment banking, asset management and proprietary trading.

Originally the Bank was incorporated for a fixed term of 25 years ending in 2007, which was subsequently extended to 2032 pursuant to a resolution of the shareholders and the approval of Bahrain's Ministry of Commerce. In August 2005, the Bank amended its Memorandum and Articles of Association to convert from an Exempt Company "E.C." to a Bahrain Shareholding Company, "B.S.C.". As part of that process, BMB acquired an indefinite corporate life.

BMB's shares are listed on the Bahrain Stock Exchange under Reuters code BMEB.BH.

Until July 1999, the Bank's principal shareholder was Burgan Bank SAK of Kuwait, which held a 28.6% stake. Burgan Bank sold its shareholding in BMB late in 1999. As a result of that sale, Al-Fawares Holding (formerly Al Fawares Construction and Development) ("Al Fawares"), a private Kuwaiti company, became the Bank's major shareholder with a stake of about 18%. In August 2005, following a capital reorganization and rights offering, Al-Fawares increased its shareholding to 64.6%. No other single shareholder owns 10% or more of the Bank's shares. The balance of BMB's shares is held by over 13,000 shareholders primarily throughout the Gulf region.

From 1982 to 1992, the Bank focussed on international commercial banking activities with overseas operations in the USA, UK, Netherlands, Switzerland and Hong Kong. A new management team was appointed in 1993, which implemented a new strategic direction of transforming BMB into a niche investment bank serving selected clients in the Gulf Co-operation Council ("GCC") countries and the Arab world. Determined to compete only in markets where it had a competitive edge, the Bank divested activities that did not meet with its focus on investment banking, treasury products and investor marketing.

BMB has a wide range of business alliances with leading investment banks, commercial banks and private equity asset managers throughout the G-7 countries. It works with these partners to develop innovative investment banking products which add value for its clients and shareholders.

In April 2000, the Bank launched a rebranding campaign and is now known as BMB Investment Bank. BMB's legal name remains Bahrain Middle East Bank (B.S.C.).

MISSION, STRATEGY AND FRANCHISE

OUR MISSION

Our goal is to be a premier Gulf-based investment bank, recognised for providing profitable and innovative quality investment products to our clients and sustainable attractive returns to our shareholders.

We aim to deliver a high standard of performance in all aspects of our activity:

- Superior, consistent returns on investment for our shareholders and clients.
- Sustainable, mutually beneficial endeavours with leading global investment and commercial banks.
- A professional and rewarding working environment for our staff.

OUR STRATEGY

We seek to grow our business through:

- Anticipating shifts in fundamental macroeconomic and demographic trends.
- Aligning our business strategies to take advantage of these changes.
- Delivering innovative, high quality investment products and services to our clients.

OUR FRANCHISE

We believe our franchise is the unique combination of:

- The ability to identify shifts in underlying fundamental macro and demographic trends.
- Efficient administration and decision making, which enables us to move quickly to take advantage of changing trends without compromising internal controls or risk management.
- Strong relationships with asset managers and deal originators, which facilitate sourcing investments quickly in our target investment sectors.
- Deep knowledge of our investor base, which allows us to identify those opportunities most relevant to our clientele.
- Innovative, sophisticated and dedicated staff, capable of structuring these opportunities into attractive transactions for our clients and for the Bank.
- Solid placement capabilities in the GCC countries and the Levant.

DIRECTORS' AND CHIEF EXECUTIVE'S REPORT TO THE SHAREHOLDERS

On behalf of the Board of Directors, we are pleased to report to you on BMB's financial performance in Fiscal Year 2007 as well as provide an insight into our plans for the future.

Globally 2007 was a year of contrasts. It began on a strong note with record deal volumes and buoyant markets. It ended with serious distress in the money and credit markets resulting from the fallout from the subprime and leveraged loan crises.

BMB was not affected by these crises as we have no direct or indirect exposure to the subprime or leveraged loan sectors. Of course, no financial institution is immune from developments in the financial markets and the world economy. An economic slowdown will affect BMB, but we believe our assets are sound and of proven income and cash generating ability.

For BMB 2007 was another year of significant sustained progress, as it has been the last three years.

Net income was strong.

In our 2006 report we noted that results for that year were the second best in the Bank's history. In 2007 our net profit rose by 16.6%. As a result, we are in the happy position of repeating that statement though with one slight modification – 2007 is now the second best earnings year in the Bank's history. BMB is back. The foundation has been set and 2008 will be, as discussed below, a year of significant initiatives.

BMB reported consolidated net profit of US\$ 24.6 million, a 16.6% increase over 2006's net profit of US\$ 21.1 million. As in years past the bulk of investment income arose from our private equity funds portfolio with revenues of US\$ 24.0 million versus US\$ 24.9 million in 2006. Foreign exchange translation income amounted to US\$ 1.9 million versus US\$ 6.1 million in 2006. Fees and commission income stood at US\$ 2.5 million versus 2006's US\$ 3.2 million. In December 2007, the Bank sold its headquarters building. As required by IFRS accounting principles, the income and expenses associated with the building have been included in the net income from asset sales of US\$ 13.2 million. For comparative purposes, 2006 building related income and expenses of US\$ 0.3 million have been reclassified.

In 2007 we continued to strengthen our balance sheet.

Shareholders' Equity increased from US\$ 46.4 million in 2006 to US\$ 71.4 million in 2007, a 53.9% increase due to internally generated profitability and increases in the fair value reserve for investments. This follows a 70.4% increase from 2005 to 2006. In June we made the scheduled US\$ 15.2 million repayment on the US\$ 75 million facility, reducing it to US\$28.5 million, a cumulative 62% reduction. Using the proceeds from the building sale and internally generated funds, BMB plans to prepay the remaining balance of this loan during February 2008. Year over year total assets increased by US\$ 8.2 million to US\$ 180.9 million. As a result of these factors, our Basel I capital adequacy ratio improved to 31.4% compared to 20.2% in 2006.

2008 marks the formal implementation of Basel II in the Kingdom of Bahrain. We are pleased to report that BMB begins the new year with a Basel II capital adequacy ratio of 24.0%, a very strong starting position.

In view of this strong financial performance and reflecting our desire to strengthen paid-in-capital, the Board of Directors is recommending a 5% stock dividend for 2007, subject to shareholder and regulatory approvals.

At BMB, one of our core strategic principles is running our businesses with a medium to long term view. Accordingly, we look beyond near term conditions to position our businesses to optimally exploit fundamental shifts in underlying macroeconomic and market trends.

While 2007 results are gratifying and BMB's financial foundation is sound, we know we must plan for the future today and take actions now to ensure the long term success of BMB.

Throughout the latter half of 2007, working with the Bank's management the Board has been engaged in this process, major results of which are:

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- (1) New Product Initiatives – As part of the Board and executive management’s ongoing review of the Bank’s strategic and tactical plans, we have identified several new attractive investment vehicles, utilizing the Bank’s core competency of alternative asset selection and management. We intend to launch these during 2008 to offer both the Bank and our clients attractive risk-adjusted returns.
- (2) Internal Organization and Resource Development – To implement these plans in 2008, the Bank reorganized certain existing departments as well as created new Strategic Planning department. BMB has already begun the process of recruiting staff to fill positions in this department as well as to upgrade and strengthen its existing departments, including the Investor Marketing Department.
- (3) Funding – As noted above, BMB intends to prepay the US\$ 75 million facility in full in February 2008, four months early. This step will provide additional operational and strategic flexibility to BMB. It is also hoped that this action will increase our access to market based funding as well as set the foundation for an improvement in our ratings.
- (4) Capital Increase – The Board will recommend that shareholders approve an increase in equity to approximately US\$ 150 million to provide a solid foundation for planned new initiatives and products. The capital increase is targeted for later in 2008 after the above three steps have been completed.

The past few years have been both challenging and exciting times at BMB.

We have rebuilt our foundation and demonstrated the earnings power and validity of our business model – an achievement made even more enjoyable by the fact that we did it under particularly challenging circumstances.

Now we are moving forward to take BMB to the next level by expanding the breadth and depth of our businesses. 2008 promises to be an important year for initiatives and implementation.

As we embark on these steps, we would like to acknowledge the many parties who contributed to our success in 2007 and with whom we hope to work closely in the future.

First and foremost, we would like to thank His Majesty the King, H.R.H the Prime Minister, H.R.H the Crown Prince, the Government of Bahrain, and the Central Bank of Bahrain for their constant actions to develop and strengthen the local economy as well as for their wise guidance and advice. We would also like to express our appreciation to the investment and commercial banks, private equity fund managers, other finance industry professionals and clients with whom we conduct our business. Finally we would like to recognize our shareholders, Board of Directors and our staff whose dedication, talent and loyalty are key to our ability to execute our strategy.

To all these parties our most sincere thanks.

We look forward to building on these important relationships in 2008 and beyond.



Wilson S. Benjamin
Chairman



Sheikh Abdulla A.K. Al Sabah
Vice Chairman



Albert I. Kittaneh
Chief Executive

10 February 2008

BMB Board of Directors and Board Committees

Board of Directors

Mr. Wilson S. Benjamin	Chairman, Non-Executive Director
Sheikh Abdulla Ali K. Al Sabah	Vice Chairman, Non-Executive Director
Sheikh Ali Khalifa A. Al Sabah	Member, Independent Non-Executive Director
Dr. Awadh Kh. Al-Enezi	Member, Independent Non-Executive Director
Mr. Ebrahim A. S. Bu Hendi	Member, Independent Non-Executive Director
Mr. Karunaker Nampalli	Member, Non-Executive Director
Mr. Alwaleed Kamal	Member, Independent Non-Executive Director
Mr. Mazen I. Abdulkarim	Member, Independent Non-Executive Director

Executive Committee

Sheikh Abdulla Ali K. Al Sabah	Chairman
Mr. Wilson S. Benjamin	Vice Chairman
Sheikh Ali Khalifa A. Al Sabah	Member
Mr. Albert I. Kittaneh	Non-voting member

Audit Committee

Dr. Awadh Kh. Al-Enezi	Chairman
Mr. Ebrahim A.S. Bu Hendi	Vice Chairman
Mr. Karunaker Nampalli	Member

Notes:

- (1) The Board of Directors was elected by the Bank's shareholders at the Ordinary General Meeting held on 11 May 2005 for a three-year term ending in 2008. Subsequent to that election and as a result of his appointment as a Minister in the Kuwaiti Government, Sheikh Ali Jarrah Al Sabah resigned from the Board where he had served as Chairman. Mr. Abdulaziz A. Abdulmalik resigned as a director in May 2006. Mr. Karunaker Nampalli joined the Board in July 2006. In January 2007, the Board elected Mr. Alwaleed Kamal to replace Mr. Abdulaziz A. Abdulmalik as an Independent Director. Mr. Mazen Abdulkarim was elected to the Board on 17 April 2007 as an Independent Director.
- (2) Designation of Directors as "Executive", "Non-Executive" and "Independent" is in conformity with the definitions and materiality thresholds in Volume 1 Module HC of the Central Bank of Bahrain's Rulebook for Wholesale Banks.
- (3) As the representatives of Al Fawares Holding (formerly Al Fawares Construction and Development Company) on the Bank's Board Mr. Benjamin, Sheikh Abdulla A. K. Al Sabah and Mr. Nampalli are not considered "Independent Directors" as defined by the Central Bank of Bahrain.
- (4) No member of management serves on the Board of Directors. Hence, the Bank has no "Executive Directors".

Mr. Wilson S Benjamin (Director since March 2000)

Chairman of the Board of Directors, and Vice Chairman of the Executive Committee.

Prior to his election as Chairman of the Board of BMB in March 2006, he was the Vice Chairman of the Bank. Since 1992, he has been the President and Chief Executive Officer of Al-Fawares Co where he is responsible for Al-Fawares investments and participation in the management of certain of its portfolio companies.

He is also the Chairman of the Board of Directors and Chief Executive Officer of ATO Ram 2 Ltd., where he is responsible for managing ATO's operations and its investments in public and private companies in the United States, Europe and the Gulf States. Since 2003, Chairman of Lotus Real Estate Co., a real estate development company in Egypt and Board Member of Authentium, a company in the security software industry based in U.S. Mr. Benjamin received a B.A. in Business Administration from Al-Hikma University in Baghdad, Iraq.

Sheikh Abdulla Ali K Al Sabah (Director since May 2005)

Vice Chairman of the Board of Directors and Chairman of the Executive Committee

Prior to his election as Vice Chairman in March 2006, Sheikh Abdulla was a member of the Board of Directors. Sheikh Abdulla is the Chairman & Managing Director of Al Fawares Holding for Financial Investments, a subsidiary of Al Fawares where he is responsible for Al Fawares investments in Egypt and Africa, Executive Vice President, Al Fawares Holding Co., Chairman of Lotus Air a charter company in Egypt, General Manager of Universal Media in Kuwait, Board Member of Authentium a company in the security software industry based in the U.S., and serves on the Boards of many other companies in Kuwait and the U.S. He has a Master's in Finance from George Washington University.

Sheikh Ali Khalifa A Al Sabah (Director since March 2000)

Director and Member of the Executive Committee

Sheikh Ali Al Sabah is a member of the ruling family of Kuwait. Sheikh Ali was Minister of Oil and Minister of Finance for Kuwait between the years 1978 and 1991. Sheikh Ali was also Chairman and Managing Director of Kuwait Real Estate Bank from 1998 to 2000. He holds a Master of Economics, University of London, England.

Dr. Awadh Kh. Al-Enezi (Director since October 1999)

Director and Chairman of the Audit Committee (since May 2005)

A PhD graduate of Bath University in 1991 and the University of New York in 1995, Dr. Al-Enezi is a lecturer at the University of Kuwait. A recipient of numerous awards, he has published several studies dealing with the socio-economic culture in Kuwait. He is an active board member of several institutions.

Mr. Ebrahim A S Bu Hendi (Director since May 2005)

Director and Vice Chairman of the Audit Committee (since May 2005)

Over thirty years of banking/treasury experience gained through working with the following institutions, Citibank, Chase Manhattan, Paribas and National Commercial Bank, Saudi Arabia. The last ten years were at Bank of Bahrain & Kuwait as AGM – Treasury, Investment and overseas branches. Mr Bu Hendi has an MBA from Sheffield Hallam University, UK. He is a Board member/Chairman of Audit Committee of Bahrain Commercial Facilities Company since March 2007.

Mr. Karunaker Nampalli (Director since July 2006)

Director and Member of the Audit Committee (since August 2006)

Over thirty years of banking experience in India and the GCC, in operations, trade finance, project finance, corporate banking, credit, and client relationship management, including most recent positions at Burgan Bank and Kuwait Real Estate Bank in Kuwait. During his career, he has been active in staff training, both in terms of preparing manuals and reference materials for training as well as conducting seminars.

Mr. Nampalli is a graduate of Osmania University and is a Certified Associate of the Indian Institute of Bankers as well as having earned a Post Graduate Diploma of Export-Import Management from Bharatiya Vidya Bhavan, Delhi.

Mr. Alwaleed Kamal (Director since January 2007)

Director

Over 18 years of experience in investment and commercial banking with Citibank and BMB Investment Bank in cash management, treasury, and wealth management. At BMB Mr. Kamal was AGM and Head of Investor Marketing where he was responsible for building BMB's client business. Since 2003, he has served as a director and senior consultant in Impact W.L.L., a regional firm, specializing in consulting and advisory work, for financial institutions. Mr. Kamal holds an MBA from the University of Hull in the U.K.

Mr. Mazen Ibrahim Abdulkarim (Director since April 2007)
Director

Over 14 years of banking, private equity and investment experience gained through working in major financial centers: London, Hong Kong, New York and Bahrain. Mr. Abdulkarim currently serves as an advisor to Cayenne Asset Management Ltd in London, which manages an Irish listed hedge fund and a listed closed end investment trust on the London Stock Exchange. He also runs a family office and a proprietary investment portfolio.

His first assignment was with Arab Banking Corporation, based initially at its subsidiary, International Bank of Asia in Hong Kong, and subsequently at its head office in Bahrain. In 1997 he joined Bank of Bahrain & Kuwait, where he was responsible for international debt, trade and investment portfolios. Thereafter, he served as a member of the private placement team at Investcorp Bahrain, where he completed the Chase Manhattan Credit Training Program. Subsequently, he joined Merrill Lynch International Bank Ltd in London, qualifying for FSA and NASD accreditation as a financial consultant. He holds a BSc with honors in Finance from Bentley College, USA.

Mr. Albert I. Kittaneh
Chief Executive

Over thirty four years of experience in investment and commercial banking with The Bank of New York, Manufacturers Hanover Trust, Chemical Bank, and BMB. He is also the Vice Chairman and Chairman of the Executive Committee of Securities Investment Company (SICO) and Board Member of Oryx Capital International Ltd., Saudi Arabia, MAK Holdings (Lebanon) and a member of the executive committee of the Bankers Society of Bahrain. He has a BA in Economics from Fordham University and an MBA from Columbia University.

DESCRIPTION OF BUSINESS ACTIVITIES

Our main activities are:

- investment banking which forms the core of our activities
- asset management and funds distribution, and
- trading and investment

We carry out these activities through dedicated specialist business units.

Investment banking

This activity consists of originating and structuring investments. It is conducted by our Corporate Finance Department.

Private equity

Since 1988, the Bank has developed strong relationships with premier unquoted equity fund managers, both directly and through private equity fund distributors. Drawing on our own fundamental macro trend analysis, we seek out unquoted equity funds and direct investments which meet our stringent investment criteria. These investments are both for the Bank's own account and for clients.

Our primary focus is on fund managers who pursue a strategy of taking a controlling interest in high quality investments with a solid financial history. The fund managers selected by BMB must be able to demonstrate both a proven track record over a number of years and economic cycles, as well as strong institutional backing. They must have a strict pricing discipline, make investments with a pre-determined exit strategy and for the most part must not merely be sourcing transactions through the auction process.

Private placements

During 2007, BMB continued to raise equity on a private placement basis for mid-size companies. Our Corporate Finance Department and executive management originate transactions drawing on BMB's network of contacts. After a satisfactory internal review and structuring, the Bank places the transactions with its customers.

Asset management/ funds distribution

This activity consists of marketing investment products to BMB's individual and institutional clients and the management of BMB proprietary funds. Our Investor Marketing Department has responsibility for the former, while our Corporate Finance Department handles funds management.

Investor marketing

Our Investor Marketing Department distributes structured products and private equity transactions to our investor base. This group also markets other specially developed products, including private equity funds, listed funds and hedge funds which are designed to meet our clients' needs. For our proprietary funds, we provide a full range of accounting, reporting and support services.

Investor Marketing is based upon our knowledge of each client's investment objectives and risk parameters. This detailed understanding enables us to focus product development and marketing efforts to more effectively meet our clients' needs. It also facilitates the cross-selling of other products and establishment of long-term client relationships.

Investor Marketing is supported by a dedicated Client Operations Unit within our Operations Department.

Funds management

The Bank manages BMB's first fund of private equity funds, BMB Technology & Telecommunications Company, a US\$ 70 million fund. We were also actively involved in BMB Shield through our role as Investment Advisors to this fund. During 2006, the BMB Shield fund matured, investors were repaid and the Fund was wound up. BMB's role as Investment Advisor was, therefore, concluded.

Publicly traded equities, private equities, capital markets, foreign exchange

In 2007, BMB did not actively trade in foreign exchange, capital markets or related derivative instruments... The Bank did engage in limited selective investments in GCC equities and GCC funds. Additionally, the Treasury managed the Bank's portfolio of listed equities, which primarily consist of IPOs or listed shares resulting from the realization of private equity investments.

Corporate Governance

BMB conducts its business activities under a written corporate governance framework which sets forth the roles and responsibilities of members of the board of directors and bank management.

In brief the Board is ultimately responsible for the performance of the Bank. The Board discharges that responsibility through (a) setting the strategic direction of the Bank by approving an appropriate business strategy, including the identification, acceptance, monitoring and management of risks (b) establishing a robust corporate governance system, which includes risk limits, internal controls, policies and procedures and a system to foster compliance with applicable laws and as well as professional standards and ethics by itself and Bank staff and monitoring the same for implementation, (c) reviewing its own and bank management's performance and (d) reporting the Bank's results in a fair and transparent manner.

To assist it in the discharge of its duties, BMB's Board has created two committees: the Executive Committee and the Audit Committee. These Committees undertake tasks defined in their Charters on behalf of the Board, though in all cases the Board subsequently reviews and approves their actions.

The Executive Committee acts in place of the Board in case of urgent matters. It is also responsible for (a) managing the Bank's risk strategy and limits, (b) assessing the performance of Board members and senior executives of the Bank, including the latter's compensation, (c) major capital resource acquisition and allocation, (d) recruitment of board members and, as appropriate, senior Bank executives, including succession planning and (e) other tasks as assigned by the Board. Accordingly, the Executive Committee acts in the capacity of the Board's Remuneration and Nomination Committee.

The Audit Committee is charged with overseeing the integrity of the Bank's financial reporting, including the choice of accounting policies, reasonableness of any estimates or assumptions used in the preparation of the Bank's financials and thus the completeness and transparency of these reports. As part of its duties, the Audit Committee directly oversees the work performed by the Bank's External Auditors and Internal Auditors. Through these activities, the Committee monitors the appropriateness of Bank's policies and procedures and other internal controls and their implementation. The Committee also monitors compliance with local laws, including Insider Trading regulations, and the Bank's Code of Ethics. As per the Bank's policy, the Chairman of the Audit Committee must be an Independent Non Executive Director.

The composition of the Board, membership in Board committees, a brief description of each Board member's qualifications and regulatory classification is provided on pages 5, 6 and 7.

In the discharge of its duties the Board reserves some rights and responsibilities for itself and delegates others to Bank management.

Bank management's role is to implement the Board's strategy within the authorities delegated to it. This involves primarily the day to day management of the Bank's affairs, including the conduct of business along with oversight of the Bank's various operating and monitoring systems.

To assist executive management in the discharge of its duties, executive management has created two committees: the Risk Management Committee and the Management Committee.

The Bank manages its credit and market risks primarily through the Risk Management Committee ("RMC"). The RMC is composed of the Chief Executive, the Chief Operating Officer, the Head of Risk Management Department, the Head of Treasury, the Head of Corporate Finance and the Group Finance Controller (the latter three in a non-voting capacity).

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The Bank's Management Committee is composed of members of the RMC and the functional division heads. It serves as a forum for the discussion of the Bank's overall strategy, product development, marketing and other significant business issues. As required, working groups composed of Management Committee members are formed to study specific issues and recommend actions for executive management approval.

In addition, several other parties play important roles in corporate governance and control at BMB: the Bank's external auditors, its internal auditors, its compliance officer, money laundering reporting officer and Risk Management Department.

The Bank's independent auditors, PricewaterhouseCoopers, have unhindered access to the Audit Committee, Executive Committee, and the Board of Directors, with or without members of management being present to discuss their audit findings and any other matter which should be brought to the attention of the Board.

The Bank's internal audit function (a) reviews policies and procedures for adequacy as well as compliance with applicable regulations and laws and (b) assesses the implementation of and adherence to policies and procedures by the Bank using a risk based approach. Internal audit reports directly to the Audit Committee of the Board of Directors, who approve the yearly internal audit plan, and all audit reports independent of the Bank's management. Beginning in 2006, the Bank outsourced its internal audit function to an internationally reputed accounting firm after receiving Central Bank of Bahrain approval.

To monitor its compliance with local laws and regulations, the Bank has appointed a Compliance Officer and a separate Money Laundering Reporting Officer ("MLRO") specifically for anti money laundering. The Bank appointed a second senior officer to serve as Deputy MLRO in the absence of the MLRO. Additionally, the Bank has appointed a Disclosure Compliance Officer for Central Bank and Bahrain Stock Exchange disclosure requirements.

Finally, the Bank has an independent Risk Management Department, whose functions are discussed in detail under the Risk Management Section.

The Bank's corporate governance framework is set forth in a series of documents:

- Code of Ethics and Code of Conduct
- Corporate Governance Policies and Procedures
- Charter of the Board of Directors
- Directors' Roles and Responsibilities
- Charter of the Executive Committee of the Board of Directors
- Charter of the Audit Committee of the Board of Directors
- Charter of the Chairman of the Board of Directors
- Charter of the Chief Executive
- Disclosure Policy and Procedures

Copies of these documents are available on the Bank's website at <http://www.bmb.com.bh/corporate/more.asp>

SUMMARY OF FINANCIAL PERFORMANCE 31 DECEMBER 1997 – 2007

The key financial ratios from 31 December 1997 - 2007 are summarised as follows:

ILLUSTRATION 1**SUMMARY OF FINANCIAL DATA 1997-2007****(all figures in thousands of US dollars)**

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
Net income/(loss) - as reported	<u>24,617</u>	<u>21,115</u>	<u>6,165</u>	<u>594</u>	<u>(12,754)</u>	<u>(50,786)</u>	<u>(15,647)</u>	<u>(56,985)</u>	<u>30,085</u>	<u>13,711</u>	<u>18,658</u>
Add/(deduct):loss/(profit) from discontinued operations	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,951</u>	<u>(5,081)</u>
Net income/(loss) from continuing operations	<u>24,617</u>	<u>21,115</u>	<u>6,165</u>	<u>594</u>	<u>(12,754)</u>	<u>(50,786)</u>	<u>(15,647)</u>	<u>(56,985)</u>	<u>30,085</u>	<u>23,662</u>	<u>13,577</u>
Growth/(decline) in net income (%)	16.6%	242.5%	937.9%	104.7%	74.9%	(224.6%)	72.5%	(289.4%)	27.1%	74.3%	96.9%
Total shareholders' equity	71,436	46,427	27,248	(27,777)	(28,085)	(20,874)	43,170	65,455	131,488	108,741	102,121
Total assets	180,879	172,666	168,411	182,004	180,695	190,548	512,833	622,620	655,579	739,195	751,533
Return on average shareholders' equity (%)	41.8%	57.3%	N/A	N/A	N/A	(455.6%)	(28.8%)	(57.9%)	25.1%	23.7%	14.2%
Return on average assets (%)	13.9%	12.4%	3.5%	0.3%	(6.9%)	(14.4%)	(2.8%)	(8.9%)	4.4%	3.2%	2.0%
Operating expenses/total income (%)	36.9%	31.0%	48.2%	N/A	N/A	N/A	N/A	N/A	28.0%	27.4%	40.6%
Average net income/ (loss) per employee	359	319	95	9	(196)	(794)	(216)	(712)	421	376	238
Financial leverage (times)	1.4:1	2.6:1	4.9:1	N/A	N/A	N/A	10.6:1	8.3:1	3.9:1	5.7:1	6.9:1
Net liquid position (US\$ mill.)	(24)	(38)	(35)	(107)	(98)	(77)	(47)	45	64	70	51

The effects of prior period adjustments have not been reflected for periods earlier than 2005.

Effective 1 January 2001, BMB adopted IAS 39 which requires application of the new accounting policies only on a prospective basis. While the balance sheet for 2000 has been restated to retrospectively apply IAS 39, the balance sheets for prior periods have not been restated.

FINANCIAL REVIEW

The following section analyzes BMB's financial performance for the year ended 31 December 2007 compared to 2006.

INCOME STATEMENT**OVERVIEW OF FINANCIAL RESULTS**

The following points summarize BMB's 2007 financial performance:

- The net profit for the year was US\$ 24.6 million compared to a profit of US\$ 21.1 million in 2006.
- Income from investments totalled US\$ 23.2 million as compared to US\$ 27.2 million in 2006.
- Gain from foreign exchange totalled US\$ 1.9 million as compared to US\$ 6.1 million in 2006.
- Fees and commissions totalled US\$ 2.5 million as compared to US\$ 3.2 million in 2006.
- Net interest expense stood at US\$ 3.9 million against US\$ 5.4 million in 2006.
- Impairment provisions stood at US\$ 3.5 million compared to US\$ 0.5 million in 2006.
- Net income from assets sold totalled US\$13.2 million compared to US\$ 0.3 million in 2006.

Net profit

The net profit for the year in 2007 amounted to US\$ 24.6 million. The main contributors to this profit were from operations: income from unquoted equity investments US\$ 24.0 million (2006: US\$ 25.0 million), unrealized foreign exchange income US\$ 1.9 million (2006: US\$ 6.1 million), as well as fees and commissions US\$ 2.5 million (2006: US\$ 3.2 million).

This was partially offset by impairment provisions of US\$ 3.5 million (2006: US\$ 0.5 million).

In addition to the above, net income from assets sold increased the net profit for the year 2007 by US\$ 13.2 million, as the Bank sold its headquarters building in late December 2007.

Income from investments

The income from investments amounted to US\$ 23.2 million compared to US\$ 27.2 million in 2006. As the private equity market continued to record strong multiples in 2007, income from equities and funds continued to be the main source of income for BMB. Unrealized losses in trading equities, fund and derivatives were results of global turbulent financial markets, triggered by the effects of the U.S. subprime crisis. The results of the Bank's various investment activities are summarized in the table below:

ILLUSTRATION 2**ANALYSIS OF INCOME FROM INVESTMENTS**

	<u>2007</u> US\$000	<u>2006</u> US\$000
Income/(loss) from managed funds – trading	5	(148)
(Loss)/income from quoted equities – trading	(1,295)	1,704
Income from sovereign debt and bonds – trading	72	173
Income from other equities and funds	23,923	24,908
Income from other bonds	1	73
(Loss) from derivatives	(39)	-
Dividend income	<u>506</u>	<u>484</u>
Total income from investments	<u><u>23,173</u></u>	<u><u>27,194</u></u>

Foreign exchange translation

Foreign exchange translation gain stood at US\$ 1.9 million compared to US\$ 6.1 million in 2006. The Bank's foreign exchange earnings remain subject to volatility due to insufficient foreign exchange trading lines to hedge non-US dollar denominated assets. The Bank hopes to make further strides in improving this situation through the course of 2008.

BMB INVESTMENT BANK

Fees and Commissions

Fees and commissions amounted to US\$ 2.5 million compared to US\$ 3.2 million in 2006, a decrease of US\$ 0.7 million. This decrease was mainly due to the following:

- **Performance fees** – lower levels of investment realizations within private equity funds, where BMB earns fees on the profit sharing arrangements with its customers.
- **Management fees** – lower outstanding balances within the BMB Tech fund.
- **Placement fees** – a lower volume of products marketed to our clients as the Bank reduced its placement activity with the onset of the subprime and credit crisis as well as timing differences with fees on certain placements, marketed in 2007, to be collected in 2008.

Fees and commissions are summarised in the following table:

ILLUSTRATION 3
ANALYSIS OF FEES AND COMMISSIONS

<u>Detail</u>	<u>2007</u> <u>US\$000</u>	<u>2006</u> <u>US\$000</u>	<u>Increase/</u> <u>(decrease)</u> <u>US\$000</u>	<u>Increase/</u> <u>(decrease)</u> <u>%</u>
Performance fees	1,859	2,000	(141)	(7.1%)
Management fees	517	629	(112)	(17.8%)
Placement fees	82	584	(502)	(86.0%)
Others	<u>18</u>	<u>20</u>	<u>(2)</u>	<u>(10.0%)</u>
Total fees and commissions	<u>2,476</u>	<u>3,233</u>	<u>(757)</u>	<u>(23.4%)</u>

Operating expenses (general and administrative)

Operating expenses amounted to US\$ 8.7 million for 2007 compared to US\$ 9.3 million in 2006, a decrease of US\$ 0.6 million. This decrease is mainly attributed to T&T Beverages (in liquidation effective April 2006), a decrease of US\$ 1.0 million in expenses. Operating expenses are summarised in the following table:

ILLUSTRATION 4
ANALYSIS OF OPERATING EXPENSES (General and Administrative)

<u>Detail</u>	<u>2007</u> <u>US\$000</u>	<u>2006</u> <u>US\$000</u>	<u>(Increase)/</u> <u>decrease</u> <u>US\$000</u>	<u>(Increase)/</u> <u>decrease</u> <u>%</u>
Staff costs	6,650	6,316	(334)	(5.3%)
Occupancy and equipment expense	347	464	117	25.2%
Other costs	<u>1,739</u>	<u>2,511</u>	<u>772</u>	<u>30.7%</u>
Total operating expenses	<u>8,736</u>	<u>9,291</u>	<u>555</u>	<u>6.0%</u>

Provisions for impairment

BMB takes provisions if a financial asset is impaired, that is, if its carrying amount is greater than its estimated recoverable amount. Provisions for assets carried at amortised cost are calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate. By comparison, the recoverable amount of an instrument measured at fair value is the present value of expected future cash flows discounted at the current market rate of interest for a similar financial asset.

BMB INVESTMENT BANK

The required levels of investment provisions are determined after a careful review of the underlying economic factors and the investee company's past and future forecasted financial performance which may eventually impact the recoverable amount of the investment portfolio.

In 2007, a net provision of US\$ 3.5 million was made compared to US\$ 0.5 million in 2006. The net increase of US\$ 3.0 million was mainly attributed by an investment which the Bank considered unrecoverable as the company went into Chapter 11 in the United States and a provision of US\$ 3.7 million was made. This was partially offset by a writeback of US\$ 0.1 million from other bonds.

BALANCE SHEET

Total assets

Total assets at 31 December 2007 were US\$ 180.9 million compared to US\$ 172.7 million at 31 December 2006, an increase of US\$ 8.2 million, or 4.8%.

This increase is mainly due to an increase in cash and deposits with banks by US\$ 23.9 million as the Bank revived its money market trading due to new lines as well as realizations on its private equity portfolio.

ILLUSTRATION 5

SUMMARY OF KEY BALANCE SHEET ITEMS

<u>Detail</u>	<u>2007</u> US\$000	<u>2006</u> US\$000
Cash and deposits with banks	36,602	12,708
Trading equities and funds	9,279	8,506
Other equities and funds	73,264	75,690
Loans and advances	967	3,222
Fixed assets	316	12,796
Bank deposits	10,015	-
Customer deposits	36,553	47,595
Medium term loan	28,500	43,700
Revolving loan facility	13,600	13,600

Cash and deposits with banks

Cash and deposits with banks increased to US\$ 36.6 million compared to US\$ 12.7 million in 2006, an increase of US\$ 23.9 million. This increase was mainly due to another record year in realizations from our private equity funds portfolio and the revival of our money market trading activities.

Trading equities and funds

Trading equities and funds increased from US\$ 8.5 million to US\$ 9.3 million, an increase of US\$ 0.8 million, as the Bank increased its trading activities.

Other equities and funds

Other equities and funds (private equity) decreased to US\$ 73.3 million from US\$ 75.7 million in 2006, a decrease of US\$ 2.4 million, or 3%. This decrease was mainly due to the Bank taking a provision against a direct investment held within the unquoted equities held at fair value portfolio which it considered unrecoverable, as the company went into Chapter 11 in the second quarter of 2007.

Our unquoted equity fund investments held at fair value had another good year in 2007 as revaluations continued to increase by US\$ 13.6 million (2006: US\$ 9.0 million). This was offset by equally strong realizations from the portfolio within the year.

Undrawn other equity fund investment commitments decreased to US\$ 31.9 million in 2007 from US\$ 35.6 million in 2006, a decrease of US\$ 3.7 million, or 10.4% as fund managers took advantage of market conditions and funded new investments. It is estimated that these unfunded investment commitments, which include customers' portions, will be drawn down over the course of the next six years.

BMB INVESTMENT BANK

Loans and advances

Loans and advances at 31 December 2007 decreased to US\$ 1.0 million from US\$ 3.2 million in 2006, a decrease of US\$ 2.3 million, or 70%. This decrease was mainly due to the prepayment of a specific commercial loan within the year.

Fixed assets

Fixed assets decreased from US\$ 12.8 million to US\$ 0.3 million, a decrease of US\$ 12.5 million as the Bank derecognized freehold land and building from fixed assets, pursuant to a Board of Directors decision to sell the assets in October 2007.

In late December 2007, the Bank signed a definitive sale agreement.

Bank deposits

Deposits from banks stood at US\$ 10.0 million compared to nil in 2006, as the Bank restarted its money market trading in the 4th quarter of 2007.

Customer deposits

Customer deposits decreased from US\$ 47.6 million to US\$ 36.6 million, a decrease of US\$ 11.0 million. This was mainly due to a repayment of time deposits to Government entities, corporates and individuals, in addition to net payments of US\$ 4.8 million for customer participation in funds.

Medium term loan

The medium term loan decreased by US\$ 15.2 million as the second instalment due in June 2007, under the refinancing agreement was paid. The Bank plans to prepay the third and final instalment US\$28.5 million (due June 2008) in February 2008.

Revolving loan facility

<u>Detail</u>	<u>2007</u> <u>US\$000</u>	<u>2006</u> <u>US\$000</u>
Revolving loan facility	13,600	13,600

On 30 December 2003, the Bank signed a US\$ 20 million three-year revolving facility secured by certain of the Bank's private equity investments. This facility was designed to provide liquidity to the Bank. The utilised amount at 31 December 2007 was US\$ 13.6 million (31 December 2006: US\$ 13.6 million). By an amended agreement signed in December 2006, the facility was extended to 30 December 2007 and bearing interest at floating Libor plus 25 basis points.

In December 2007, an additional amendment agreement was signed, extending the facility to 30 June 2008, with a revised interest rate of floating US\$ Libor plus 80 basis points.

Other balance sheet items

Other bonds: The Bank's portfolio of other bonds increased to US\$ 9.8 million from US\$ 9.7 million in 2006. This increase resulted from an increase in amortized costs of CDO's, which are secured by U.S. Government securities. This was offset by receipts of partial repayments on student loan notes.

Derivatives: In early December 2007, the Bank took small positions in equity derivatives, as an initial step to active trading.

BMB INVESTMENT BANK

Capital ratios

The guiding principle of the Bank is to maintain risk based capital ratios in excess of the prescribed minimum of 12.0% by the Central Bank of Bahrain.

At 31 December 2007, the total capital ratio using the standardised approach was 31.36% compared to 20.22% at 31 December 2006.

The risk based capital ratios of the Bank include market risk weighted assets using the standardised approach and the credit risk weighted assets based on the BIS 1988 Capital Accord.

ILLUSTRATION 6
CAPITAL BASE AND RISK WEIGHTED ASSETS

	Average for the year <u>2007</u> US\$000	At year- end <u>2007</u> US\$000	Average for the year <u>2006</u> US\$000	At year- end <u>2006</u> US\$000
<u>Tier 1 capital</u>				
Share capital	52,338	52,338	52,338	52,338
Legal reserves	14,464	16,310	12,291	13,848
General and other reserves	10,138	10,138	10,138	10,138
Retained earnings	<u>(27,840)</u>	<u>(18,599)</u>	<u>(52,124)</u>	<u>(40,575)</u>
Total qualifying Tier 1 capital	<u>49,100</u>	<u>60,187</u>	<u>22,643</u>	<u>35,749</u>
<u>Tier 2 capital</u>				
Revaluation reserves – available for sale investments	10,272	11,249	895	3,580
Fixed assets revaluation reserves	5,324	-	10,903	7,098
Subordinated loan	<u>2,257</u>	<u>-</u>	<u>4,754</u>	<u>3,989</u>
Total qualifying Tier 2 capital	<u>17,853</u>	<u>11,249</u>	<u>16,552</u>	<u>14,667</u>
Total regulatory capital	<u>66,953</u>	<u>71,436</u>	<u>39,195</u>	<u>50,416</u>
<u>Risk weighted assets</u>				
On balance sheet	213,514	207,440	222,839	223,330
Off balance sheet	<u>23,663</u>	<u>20,374</u>	<u>23,516</u>	<u>25,993</u>
Total risk weighted assets	<u>237,177</u>	<u>227,814</u>	<u>246,355</u>	<u>249,323</u>
Capital Adequacy Ratio	<u>28.23%</u>	<u>31.36%</u>	<u>15.91%</u>	<u>20.22%</u>

On 1 January 2008, the Kingdom of Bahrain implemented Basel II. Using the Basel II standardized approaches for credit and market risk as well as the basic indicator approach for operational risk, BMB's Basel II capital adequacy ratio as of this date stood at 24.0%.

Earnings per share and price/earning ratio

The Group's earnings per share and price/earnings ratio were as follows:

ILLUSTRATION 7
REVIEW OF EARNINGS PER SHARE AND PRICE EARNINGS RATIO

<u>Detail</u>	<u>2007</u>	<u>2006</u>
Net profit	US\$ 24,616,500	US\$ 21,115,000
Number of shares (fully diluted)	209,351,949	209,351,949
Earnings per share	US\$ 0.12	US\$ 0.10
BMB's year-end share price on the Bahrain Stock Exchange	US\$ 0.49	US\$ 0.26
Book value per share	US\$ 0.34	US\$ 0.22
Price/ earnings ratio	4.08	2.60

BMB shareholdings of directors, their related parties and BMB senior management

The shareholdings of directors, their related parties and BMB senior management were as follows:

ILLUSTRATION 8**DIRECTORS AND SENIOR MANAGEMENT SHAREHOLDINGS**

<u>Detail</u>	<u>2007</u> Number	<u>2006</u> Number
Directors and their related parties	136,349,632	136,349,632
Senior management	<u>95,003</u>	<u>95,003</u>
Total	<u><u>136,444,635</u></u>	<u><u>136,444,635</u></u>

ILLUSTRATION 9**SUMMARY OF PERFORMANCE BY BUSINESS SEGMENTS**

The Group is organised into two major business segments, banking and manufacturing. The respective segmental operating results for the year 2007 were as follows:

	<u>Banking</u>		<u>Manufacturing</u>		<u>Consolidated</u>	
	<u>2007</u> US\$000	<u>2006</u> US\$000	<u>2007</u> US\$000	<u>2006</u> US\$000	<u>2007</u> US\$000	<u>2006</u> US\$000
Income from investments	23,173	27,194	-	-	23,173	27,194
Foreign exchange translation income	1,923	6,062	-	-	1,923	6,062
Fees and commissions income	2,476	3,233	-	-	2,476	3,233
Other income/(expense)	58	421	(20)	(214)	38	207
Net interest (expense)/ income	<u>(3,926)</u>	<u>(5,360)</u>	<u>4</u>	<u>1</u>	<u>(3,922)</u>	<u>(5,359)</u>
Total income/(loss) from operations	<u>23,704</u>	<u>31,550</u>	<u>(16)</u>	<u>(213)</u>	<u>23,688</u>	<u>31,337</u>
Impairment provisions	(3,514)	(480)	-	-	(3,514)	(480)
General and administrative expenses	<u>(8,736)</u>	<u>(8,277)</u>	<u>-</u>	<u>(1,014)</u>	<u>(8,736)</u>	<u>(9,291)</u>
Total operating expenses	<u>(12,250)</u>	<u>(8,757)</u>	<u>-</u>	<u>(1,014)</u>	<u>(12,250)</u>	<u>(9,771)</u>
Net income/(loss) from operations before tax	11,454	22,793	(16)	(1,227)	11,438	21,566
Net income from assets sold	<u>13,179</u>	<u>259</u>	<u>-</u>	<u>-</u>	<u>13,179</u>	<u>259</u>
Net income/(loss) before taxation	24,633	23,052	(16)	(1,227)	24,617	21,825
Taxation	<u>-</u>	<u>(710)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(710)</u>
Net income/(loss) for the year	<u><u>24,633</u></u>	<u><u>22,342</u></u>	<u><u>(16)</u></u>	<u><u>(1,227)</u></u>	<u><u>24,617</u></u>	<u><u>21,115</u></u>

The banking segment represents BMB and all its subsidiaries excluding T&T Beverages Limited (T&T).

The manufacturing segment is represented by T&T only which is under voluntary liquidation since 25 April 2006.

The consolidated figures are arrived at after off-setting all intra-group transactions including T&T.

Independent auditor's report to the shareholders of Bahrain Middle East Bank (B.S.C)

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Bahrain Middle East Bank (B.S.C) (the "Bank") and its subsidiaries (together, the "Group") which comprise the consolidated balance sheet as at 31 December 2007 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

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

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

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

Independent auditor's report to the shareholders of Bahrain Middle East Bank (B.S.C) (continued)

Opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2007, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on regulatory requirements

Further, in accordance with the requirements of the Bahrain Commercial Companies Law and the Central Bank of Bahrain Law, we report that we have obtained all the information that we considered necessary for the purpose of our audit; the Bank has maintained proper books of accounts and the consolidated financial statements and the financial information contained in the Directors and Chief Executive's report, are in agreement therewith; and, nothing has come to our attention which causes us to believe that the Bank has breached any of the applicable provisions of the Bahrain Commercial Companies Law, the Central Bank of Bahrain Law, the terms of its banking license or its Memorandum and Articles of Association which would materially affect its activities or its financial position as at 31 December 2007.

PricewaterhouseCoopers

Manama, Kingdom of Bahrain
12 February 2008

BMB INVESTMENT BANK

CONSOLIDATED BALANCE SHEET
AT 31 DECEMBER 2007
(Expressed in thousands of United States Dollars)

	<u>2007</u>	<u>2006</u>
<u>ASSETS</u>		
Cash and deposits with banks (Note 3)	36,602	12,708
Trading equities and funds (Note 4)	9,279	8,506
Government bonds (Note 5)	4,388	4,388
Other equities and funds (Note 6)	73,264	75,690
Other bonds (Note 7)	9,793	9,687
Derivative financial instruments (Note 8)	83	-
Loans and advances (Note 9)	967	3,222
Instalment sale receivable (Note 10)	18,839	20,311
Fixed assets (Note 11)	316	12,796
Other assets (Note 12)	<u>27,348</u>	<u>25,358</u>
TOTAL ASSETS	<u>180,879</u>	<u>172,666</u>
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
<u>Liabilities</u>		
Bank deposits (Note 13)	10,015	-
Customer deposits (Note 14)	36,553	47,595
Securities sold under repurchase agreements (Note 15)	3,700	3,700
Medium term loan (Note 16)	28,500	43,700
Revolving loan facility (Note 17)	13,600	13,600
Other liabilities (Note 18)	7,075	7,644
Subordinated loan (Note 19)	<u>10,000</u>	<u>10,000</u>
TOTAL LIABILITIES	<u>109,443</u>	<u>126,239</u>
<u>Shareholders' equity</u>		
Share capital (Note 20)	52,338	52,338
Fair value reserve (Note 21)	11,249	3,580
Fixed asset revaluation reserve (Note 21)	-	7,098
Other reserves (Note 21)	<u>7,849</u>	<u>(16,589)</u>
TOTAL SHAREHOLDERS' EQUITY	<u>71,436</u>	<u>46,427</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>180,879</u>	<u>172,666</u>

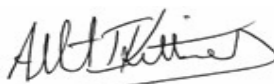
These consolidated financial statements were approved by the Board of Directors on 10 February 2008 and signed on its behalf by:



Wilson S. Benjamin
Chairman



Sheikh Abdulla A.K. Al Sabah
Vice Chairman



Albert I. Kittaneh
Chief Executive

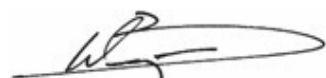
Notes 1 to 39 form an integral part of these financial statements.

BMB INVESTMENT BANK

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2007
(Expressed in thousands of United States Dollars)

	<u>2007</u>	<u>2006</u>
<u>INCOME FROM OPERATIONS</u>		
Income from investments (Note 22)	23,173	27,194
Foreign exchange translation income (Note 23)	1,923	6,062
Fees and commissions income (Note 24)	2,476	3,233
Other income (Note 25)	<u>38</u>	<u>207</u>
	27,610	36,696
Interest income (Note 26)	2,705	2,016
Interest expense (Note 26)	<u>(6,627)</u>	<u>(7,375)</u>
NET INTEREST (EXPENSE)	<u>(3,922)</u>	<u>(5,359)</u>
TOTAL INCOME FROM OPERATIONS	<u>23,688</u>	<u>31,337</u>
Impairment provisions (Note 27)	(3,514)	(480)
General and administrative expenses (Note 28)	<u>(8,736)</u>	<u>(9,291)</u>
TOTAL OPERATING EXPENSES	<u>(12,250)</u>	<u>(9,771)</u>
NET INCOME FROM OPERATIONS	11,438	21,566
NET INCOME FROM ASSETS SOLD (Note 33)	<u>13,179</u>	<u>259</u>
NET INCOME BEFORE TAXATION	24,617	21,825
TAXATION	<u>—</u>	<u>(710)</u>
NET INCOME FOR THE YEAR	<u>24,617</u>	<u>21,115</u>
EARNINGS PER SHARE (Note 20)		
Basic	US\$ 0.12	US\$ 0.10
Diluted	US\$ 0.12	US\$ 0.10

These consolidated financial statements were approved by the Board of Directors on 10 February 2008 and signed on its behalf by:



Wilson S. Benjamin
Chairman



Sheikh Abdulla A.K. Al Sabah
Vice Chairman



Albert I. Kittaneh
Chief Executive

Notes 1 to 39 form an integral part of these financial statements

BMB INVESTMENT BANK

CONSOLIDATED STATEMENT OF CHANGES IN SHAHREHOLDERS' EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2007
(Expressed in thousands of United States Dollars)

	Share capital	Fixed asset revaluation reserve	Fair value reserve	Retained earnings	Legal reserve	General reserve	Other reserves Proposed stock dividends reserve	Total other reserves	Total
At 1 January 2006	52,338	5,056	6,933	(58,954)	11,737	10,138	-	(37,079)	27,248
Exchange translation adjustment	-	-	977	(625)	-	-	-	(625)	352
Fixed asset revaluation reserve (Notes 11 and 21)	-	2,042	-	-	-	-	-	-	2,042
Net fair value gain on available- for-sale investments (Note 6)	-	-	8,966	-	-	-	-	-	8,966
Fair value reserve transferred to income statement (Note 6)	-	-	(13,296)	-	-	-	-	-	(13,296)
Net profit for the year	-	-	-	21,115	-	-	-	21,115	21,115
Transfer to reserves (Note 21)	-	-	-	(2,111)	2,111	-	-	-	-
At 1 January 2007	52,338	7,098	3,580	(40,575)	13,848	10,138	-	(16,589)	46,427
Exchange translation adjustment	-	-	2,856	(179)	-	-	-	(179)	2,677
Fixed asset revaluation reserve transferred to income (Notes 11 and 21)	-	(7,098)	-	-	-	-	-	-	(7,098)
Net fair value gain on available- for-sale investments (Note 6)	-	-	13,583	-	-	-	-	-	13,583
Fair value reserve transferred to income statement (Note 6)	-	-	(8,770)	-	-	-	-	-	(8,770)
Net profit for the year	-	-	-	24,617	-	-	-	24,617	24,617
Transfer to reserves (Note 21)	-	-	-	(2,462)	2,462	-	-	-	-
Proposed stock dividends (Note 21)	-	-	-	-	-	(2,617)	2,617	-	-
At 31 December 2007	<u>52,338</u>	<u>-</u>	<u>11,249</u>	<u>(18,599)</u>	<u>16,310</u>	<u>7,521</u>	<u>2,617</u>	<u>7,849</u>	<u>71,436</u>

Notes 1 to 39 form an integral part of these financial statements

BMB INVESTMENT BANK

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2007
(Expressed in thousands of United States Dollars)

	<u>2007</u>	<u>2006</u>
<u>CASH FLOWS FROM OPERATING ACTIVITIES</u>		
NET INCOME FROM OPERATIONS FOR THE YEAR	11,438	21,566
<u>Adjustments to reconcile net profit to net cash provided by operating activities:</u>		
Taxes paid	-	(710)
Impairment provisions (Note 27)	3,514	615
Depreciation and amortisation	58	61
Profit on sale of fixed assets	(9)	(3)
<u>Net changes in:</u>		
Trading equities and funds	(773)	(1,272)
Government bonds	-	(4,388)
Other equities and funds	6,713	8,146
Other bonds	78	122
Derivatives	(83)	-
Loans and advances	2,255	4,493
Accrued interest receivable	26	(254)
Accrued interest payable	76	147
Other assets	15,704	(15,523)
Other liabilities	(627)	1,000
Customer deposits	(11,042)	(6,563)
Change in exchange rates related to retained earnings of overseas subsidiaries	(179)	(625)
Foreign exchange movements on investments and others	(491)	(116)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>26,658</u>	<u>6,696</u>
<u>CASH FLOWS FROM INVESTING ACTIVITIES</u>		
Amount received against instalment sale receivable	1,471	1,558
Purchase of fixed assets (Note 11)	(202)	(63)
Proceeds from sale of fixed assets	9	10
Net cash flow from freehold land and building sold (Note 33)	<u>670</u>	<u>648</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>1,948</u>	<u>2,153</u>

Notes 1 to 39 form an integral part of these financial statements

BMB INVESTMENT BANK

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)
 FOR THE YEAR ENDED 31 DECEMBER 2007
 (Expressed in thousands of United States Dollars)

	<u>2007</u>	<u>2006</u>
<u>CASH FLOWS FROM FINANCING ACTIVITIES</u>		
<u>Net changes in:</u>		
Bank deposits	10,015	-
Medium term loan	(15,200)	(9,500)
Prior year dividends claimed and paid	<u>(18)</u>	<u>(20)</u>
 NET CASH (USED IN) FINANCING ACTIVITIES	 <u>(5,203)</u>	 <u>(9,520)</u>
 EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	 <u>491</u>	 <u>116</u>
Net increase/(decrease) in cash and cash equivalents	23,894	(555)
Cash and cash equivalents at the beginning of the year	<u>12,708</u>	<u>13,263</u>
 CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR (NOTE 3)	 <u>36,602</u>	 <u>12,708</u>

Notes 1 to 39 form an integral part of these financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

1 **GENERAL INFORMATION**

INCORPORATION AND PRINCIPAL ACTIVITY

Bahrain Middle East Bank (B.S.C.) (the "Bank", "BMB" or "BMB Investment Bank") is a Bahraini Shareholding Company with limited liabilities and is incorporated in the Kingdom of Bahrain. The registered office of the Bank is: BMB Centre, Building 135, Road 1702, Block 317, Diplomatic Area, Manama, Kingdom of Bahrain.

On 9 April 2007 the Central Bank of Bahrain issued a Wholesale Banking License to BMB.

The Bank is listed on the Bahrain Stock Exchange under BMEB.BH.

The Group comprises the Bank and its subsidiaries.

The principal activities of the Group are the provision of investment banking, private banking, treasury services, trading and investment, asset management and funds distribution.

REGULATION AND SUPERVISION

BMB is regulated by the Central Bank of Bahrain ("CBB").

The approval of the CBB is required for major changes to strategy, changes to senior management, the establishment of new subsidiaries and branches and the appointment/election of members of the Board of Directors.

The CBB's inspection team carries out periodic reviews of BMB and submits reports of their findings directly to the Bank's Board of Directors.

2 **SIGNIFICANT ACCOUNTING POLICIES**

Preparation of financial statements

The Group's consolidated financial statements have been prepared in accordance with and comply with International Financial Reporting Standards (IFRS). The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of land and building, available-for-sale financial assets, all derivative contracts and financial assets at fair value through profit and loss and financial liabilities held for trading.

The United States Dollar is the functional currency of the Bank and also the currency in which the Bank's share capital is denominated. Accordingly, the financial information has been prepared in United States Dollars.

Critical accounting estimates and judgements in applying accounting policies

The preparation of the Group's consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The judgements made do not significantly affect the carrying value of assets or liabilities at the balance sheet date.

New accounting standards and IFRIC interpretations

As of the date of these consolidated financial statements the Group has not early adopted any amendments to IFRS standards or IFRIC interpretations which were issued but were not yet effective.

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Basis of consolidation

The consolidated financial statements include the assets, liabilities and results of the operations of the Group. Subsidiary companies (Note 31), which are those companies (and other entities) in which the Group directly or indirectly has power to exercise control over financial and operating policies, have been consolidated, except for companies that have been acquired for a temporary period and are held exclusively with a view to resale in the near future are not consolidated.

All intra-group balances and transactions have been eliminated.

Foreign currencies

The assets and liabilities of foreign subsidiaries are translated into United States dollars at the rates of exchange prevailing at the balance sheet date. The income statements of foreign subsidiaries are translated into United States dollars at the rates of exchange prevailing on the dates of the transactions or at the average rate of exchange for the year. The exchange differences arising on translation are dealt with in shareholders' equity.

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Income and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies, are recognised in the income statement.

All translation differences on revaluation of debt securities and other monetary financial assets measured at fair value are included in foreign exchange income and losses, whereas translation differences on revaluation of non-monetary items such as equities and funds held for trading are reported as part of the trading income or loss. The translation differences on revaluation of available-for-sale equities and funds are included in the fair value reserve in equity.

Financial instruments - recognition and measurement

Financial assets

IAS 39 requires classification of financial assets into the following four categories:

- (i) financial assets at fair value through profit and loss;
- (ii) loans and receivables;
- (iii) held-to-maturity; and
- (iv) available-for-sale.

The accounting policies for each category are as follows:

Financial assets at fair value through profit and loss

This category has two sub-categories; financial assets held for trading, and those designated at fair value through profit and loss at inception. The Group classifies a financial asset in this category if it was acquired principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin or is part of a portfolio for which there is evidence of a recent actual pattern of short-term profit-taking. These financial assets are initially recognised at cost and subsequently re-measured at fair value. All related realised and unrealised gains and losses are included in net trading income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. These assets are initially recognised when cash is advanced to the borrowers and are carried at amortized cost, and derecognised when the rights to receive cash flows from them have expired or the Group has transferred substantially all risks and rewards of ownership.

Held-to-maturity

Fixed maturity investments having fixed or determinable payments and where the Group has both the positive intent and the ability to hold such investments to maturity are classified as held-to-maturity. Such investments are carried at amortised cost less provision for impairment in value. Amortised cost is calculated using the effective interest rate method. Were the Group to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available for sale.

Available-for-sale

Non-trading financial assets not falling within the definition of held-to-maturity or loans and receivables which are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Such assets are initially recognised at cost and remeasured at fair value, unless fair value cannot be reliably measured. Any changes in fair values of such assets subsequent to initial recognition are reported as movements in fair value reserve until the investment is sold, collected or otherwise disposed of, or the financial assets are considered impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement.

Purchases and sales of financial assets at fair value through profit or loss, held to maturity and available for sale are recognized on trade-date – the date on which the Group commits to purchase or sell the asset.

Financial liabilities

Financial liabilities are classified either as held for trading or other than held for trading. Liabilities held for trading are those that are held principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin and are carried at fair value. Liabilities held other than for trading are carried at amortised cost.

Derivative financial instruments and hedging

Derivative instruments are measured at fair value and are deemed held for trading unless they are highly effective hedging instruments and are designated as such. Changes in the fair values of derivatives that do not qualify as hedging instruments are measured at fair value and are recorded in the income statement.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement along with the corresponding change in fair value of the hedged asset or liability that is attributable to that specific hedged risk.

Changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised as a separate component of equity. Where the forecasted transaction or firm commitment results in the recognition of an asset or of a liability, the income or loss previously deferred in equity is included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in equity are transferred to the income statement when the hedged firm commitment or forecasted transaction affects the income statement.

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Provisions for impairment

A provision is made in respect of a financial asset that is impaired if its carrying amount is greater than its estimated recoverable amount. Provisions for assets carried at amortised cost are calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate. By comparison, the recoverable amount of an instrument measured at fair value is the present value of expected future cash flows discounted at the current market rates of interest for similar financial assets.

Trading equities and funds

Trading equities are stated at market value and realised and unrealised income or losses are included in the income statement.

Trading funds are stated at the year-end market valuation supplied by the investment managers. Unrealised income or losses and profits or losses on sale of investments in trading funds are included in income or loss from investments.

Income from trading equities, funds and quoted equities is taken to income.

Dividend income is recognised in the income statement when declared by the investee company.

Other equities and funds

Unquoted equity investments held as available-for-sale are stated at fair value or at cost if the fair value cannot be reliably measured. The fair value is determined after examining various factors including the future prospects of the investee companies.

Unquoted equity fund investments held as available-for-sale are stated at their fair values, based upon the asset values of individual investments within the funds as well as overall fund performance provided by the fund managers, expected repayment of management fees, where applicable, and the future prospects for the underlying investments.

Income is recognised in the income statement when contract for sale has been executed.

Dividend income is recognised in the income statement when declared by the investee company.

Government and Government Agency bonds

Government and Government Agency bonds held for trading purposes are stated at market value. Realised and unrealised income or losses are recorded as income or losses from sovereign debt and bonds and included in the income statement.

Government and Government Agency bonds acquired on the date of their issue are considered as loans and receivables and are carried at amortised cost using the effective interest rate method. Income or losses are recognised upon sale and recorded as income or losses from sovereign debt and bonds and included in the income statement.

Available-for-sale Government and Government Agency bonds are stated at market value. The premium paid or discount received are amortised over the remaining period to maturity of the assets acquired using the effective interest rate method and reflected in the income statement. Unrealised income or losses from changes in fair value are recorded in the fair value reserve in equity. Upon sale or disposal of a Government or Government Agency bond, the related accumulated fair value adjustments in equity are recorded as income or losses from sovereign debt and bonds included in income or loss from investments.

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Other bonds

Other bonds held for trading purposes are recorded at market value. Realised and unrealised income and losses are included in the income statement.

Other bonds held-to-maturity are stated at amortised cost. The premium paid or discount received are amortised over the remaining period to maturity of the bonds using the effective interest rate method.

Other bonds acquired at the date of issue are classified as loans and receivables carried at amortised cost using the effective interest rate method. Income or losses are recognised upon the sale of the bonds.

Loans and advances

Loans and advances are stated net of impairment provisions which are charged to the income statement.

Fees and commissions received are amortised over the period of the loan.

Instalment sale receivable

The instalment sale receivable is carried at amortised cost less provisions for impairment.

Fixed assets

Fixed assets are stated at cost as modified by revaluation less accumulated depreciation. Fixed assets, with the exception of freehold land, are depreciated on a straight-line basis over their estimated useful original lives as follows:

Building	25 years
Other fixed assets	2-8 years

Effective 30 September 2004, the Bank adopted a new policy to revalue its freehold land and building based on periodic, but at least once in every three years, valuations by an external independent valuer. Previously, land and building were carried at cost. Effective 30 September 2004, the estimated remaining useful life of the building was 20 years and the revalued amount was being depreciated over this period. As part of its policy, the Bank again revalued its land and building in December 2006 and the revalued amount of the building was being depreciated over its now useful life of 20 years from 1 January 2007.

The net impact of revaluations are recognised in the fixed assets revaluation reserve included in shareholders' equity.

Securities purchased/ sold under agreements to resell/ repurchase ("Repo agreements")

Repo agreements involve the buying or selling of Government securities, Government Agency bonds, other bonds and trading funds under agreements to resell or repurchase these securities. Repo agreements are treated as financing transactions and are stated at the amounts at which the securities, bonds and funds will subsequently be resold or repurchased as specified in the respective agreements as adjusted for accrued interest using the effective interest rate method.

Provision

Provision for legal claims are recognized when the Bank has a present obligation as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Directors' remuneration

Directors' remuneration is recognised as a liability when approved.

Share capital - Share issue costs

Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds.

Dividends

Dividends are recognised as a liability in the period in which they are approved by the shareholders.

Treasury shares

Own shares reacquired by the Bank and held at the balance sheet date are designated as treasury shares. These shares are shown as a one line deduction from the Bank's shareholders' equity. The income and losses on the sale of treasury shares are recognised in shareholders' equity.

Fees and commissions income

Fees and commissions income are recognised in the income statement on an accrual basis. Fees received upon prepayment of loans are taken to income when received. Underwriting, performance, structuring and placement fees are taken to income when earned.

Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except for those classified as held for trading or designated at fair value through profit or loss, are accrued and recognized within 'interest income' and 'interest expense' in the income statement.

Interest income from loans and advances is accrued based on contractual interest rates using the effective interest rate method.

Interest income on Government and Government Agency bonds, other bonds and instalment sale receivable are recognized on an accrual basis using the effective interest rate method.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group includes all transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets have been written down as a result of an impairment loss, interest income is recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Employee compensation costs

Employee benefits

Employee benefits and entitlements to annual leave, holiday, air passage and other short-term benefits are recognised when they accrue to employees. The Group's contributions to defined contribution pension plans are charged to the income statement in the year to which they relate. In respect of these plans, the Group has a legal and constructive obligation to pay the contributions as they fall due and no obligation exists to pay the future benefits. In respect of end of service benefits, to which certain employees of the Group are eligible, provisions are made in accordance with the labour law requirements of the applicable jurisdiction.

Taxation

Liability toward taxation is calculated in accordance with the tax laws of the applicable country and recognised using the liability method. Currently, there is no corporate taxation in Bahrain.

Use of estimates

The preparation of financial statements in conformity with International Financial Reporting Standards requires the management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the year. The estimation process involves judgement and is based on the latest information available. Actual results could differ from those estimates.

Segment reporting

A segment is a distinguishable component of the Group that is engaged in either providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenue earned from external customers and whose revenues or assets are 10 percent or more of all the segments are reported separately.

Cash and cash equivalents

Cash and cash equivalents comprise cash and short-term funds and deposits with banks.

Subordinated loans

Subordinated loans are carried at amortised cost. Interest expense is accrued based on contractual interest rates.

Medium term loan

The medium term loan is carried at amortised cost; the front-end fees paid on the loan are amortised over the life of the loan.

Bank deposits

Deposits from banks are carried at amortized cost.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 20072 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****Comparatives**

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

3 **CASH AND DEPOSITS WITH BANKS**

Cash and deposits with banks comprise:

	<u>2007</u> US\$000	<u>2006</u> US\$000
Placements with banks	34,211	10,493
Money at call	2,325	2,149
Balances with Central Bank	<u>66</u>	<u>66</u>
Total cash and deposits with banks	<u>36,602</u>	<u>12,708</u>

Balances with the Central Bank of Bahrain are not available for use in the Group's day-to-day operations.

4 **TRADING EQUITIES AND FUNDS**

Trading equities and funds comprise:

	<u>2007</u> US\$000	<u>2006</u> US\$000
Quoted equities	8,469	8,506
Managed funds	<u>810</u>	<u>-</u>
Total trading equities and funds	<u>9,279</u>	<u>8,506</u>

5 **GOVERNMENT BONDS**

Government bonds comprise:

	<u>2007</u> US\$000	<u>2006</u> US\$000
<u>Held-to-maturity</u>		
Government bonds	<u>4,388</u>	<u>4,388</u>
Total Government bonds	<u>4,388</u>	<u>4,388</u>

No movements took place in the year 2007. In 2006, the Bank received the above bonds in exchange for a past due loan.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

6 **OTHER EQUITIES AND FUNDS**

Other equities and funds comprise:

	<u>2007</u>	<u>2006</u>
	US\$000	US\$000
<u>Available-for-sale</u>		
(i) Unquoted equity fund investments - at fair value	62,190	62,225
(ii) Unquoted equity investments - at fair value	9,933	12,297
(iii) Unquoted equity investments - at cost	<u>1,141</u>	<u>1,168</u>
Total other equities and funds	<u><u>73,264</u></u>	<u><u>75,690</u></u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

6 **OTHER EQUITIES AND FUNDS (CONTINUED)**

The type and segmental distribution break up for other equities and funds is as follows:

	<u>Diversified</u>		<u>Technology</u>		<u>Others</u>		<u>Total</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
(i) Unquoted equity funds - at fair value								
<u>Buy Out Funds:</u>								
Asian	125	146	-	-	-	-	125	146
European	4,904	3,645	-	-	-	-	4,904	3,645
Italian	1,836	498	-	-	-	-	1,836	498
UK	132	278	-	-	-	-	132	278
UK & Continental Europe	15,419	11,466	-	-	-	-	15,419	11,466
US	1,783	4,750	-	-	-	-	1,783	4,750
US & European	<u>17,582</u>	<u>19,603</u>	-	-	-	-	<u>17,582</u>	<u>19,603</u>
	<u>41,781</u>	<u>40,386</u>	-	-	-	-	<u>41,781</u>	<u>40,386</u>
<u>Venture Capital Funds:</u>								
European	32	29	-	-	-	-	32	29
US	-	-	9,367	10,490	-	-	9,367	10,490
US & European	-	-	<u>2,677</u>	<u>1,885</u>	-	-	<u>2,677</u>	<u>1,885</u>
	<u>32</u>	<u>29</u>	<u>12,044</u>	<u>12,375</u>	-	-	<u>12,076</u>	<u>12,404</u>
<u>Fund of Funds:</u>								
US & European	<u>2,516</u>	<u>3,270</u>	<u>5,817</u>	<u>6,165</u>	-	-	<u>8,333</u>	<u>9,435</u>
Subtotal	<u>44,329</u>	<u>43,685</u>	<u>17,861</u>	<u>18,540</u>	-	-	<u>62,190</u>	<u>62,225</u>
(ii) Unquoted equity - at fair value								
Financial	-	-	-	-	3,339	2,250	3,339	2,250
Private Equity Financial Intermediaries	6,158	7,154	-	-	-	-	6,158	7,154
Leisure	-	-	-	-	174	174	174	174
Others	-	-	-	-	<u>262</u>	<u>2,719</u>	<u>262</u>	<u>2,719</u>
Subtotal	<u>6,158</u>	<u>7,154</u>	-	-	<u>3,775</u>	<u>5,143</u>	<u>9,933</u>	<u>12,297</u>
(iii) Unquoted equity - at cost								
Technology/ Telecommunications	-	-	1,141	1,168	-	-	1,141	1,168
Subtotal	-	-	<u>1,141</u>	<u>1,168</u>	-	-	<u>1,141</u>	<u>1,168</u>
Total other equities and funds	<u>50,487</u>	<u>50,839</u>	<u>19,002</u>	<u>19,708</u>	<u>3,775</u>	<u>5,143</u>	<u>73,264</u>	<u>75,690</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 20076 **OTHER EQUITIES AND FUNDS (CONTINUED)**

The fair values in respect of unquoted equity investments carried at an amount of US\$ 1,141,000 (2006: US\$ 1,168,000) could not be reliably determined. These unquoted equity investments are measured at cost less provisions for impairment.

At 31 December 2007, the Bank had undrawn investment commitments to private equity funds of US\$ 31,895,000 (31 December 2006: US\$ 35,611,000) (Note 36). Under the terms of the agreements with these equity fund managers, the Group is irrevocably committed to invest funds upon notice from investment managers, except for certain excused investments. Excused investments include those prohibited by local law, and in certain cases, investments contrary to Shari'ah principles where the Bank is a co-investor with its clients who apply Shari'ah principles to their investment activity. Under contractual agreements with certain fund managers, failure to honour a non-excused investment drawdown request from a fund manager can result in the forfeiture of existing investments with that fund manager.

As disclosed in Note 17, certain of the Bank's private equity investments are pledged against the revolving loan facility. As at 31 December 2007, these investments had a carrying fair value of US\$ 20.7 million (2006: US\$ 29.9 million).

Movements in other equities and funds were as follows:

	<u>2007</u> US\$000	<u>2006</u> US\$000
At 1 January	75,690	87,804
Net fair value gain on available-for-sale investments	13,583	8,966
Additions	9,220	9,599
Disposals	(15,934)	(17,745)
Fair value transferred to income statement on disposals	(8,770)	(13,296)
Impairment provisions (Note 27)	(3,381)	(615)
Foreign exchange movements	<u>2,856</u>	<u>977</u>
At 31 December	<u>73,264</u>	<u>75,690</u>

Unquoted equity investments are stated net of specific impairment provisions which are as follows:

	Unquoted equity investments - at cost	Unquoted equity fund investments -at fair value	Total	Unquoted equity investments - at cost	Unquoted equity fund investments - at fair value	Total
	<u>2007</u> US\$000	<u>2007</u> US\$000	<u>2007</u> US\$000	<u>2006</u> US\$000	<u>2006</u> US\$000	<u>2006</u> US\$000
At 1 January	1,562	-	1,562	1,472	-	1,472
Charge for the year (Note 27)	3,381	-	3,381	-	615	615
Amounts written off	(211)	-	(211)	-	(615)	(615)
Foreign exchange movements	<u>149</u>	<u>-</u>	<u>149</u>	<u>90</u>	<u>-</u>	<u>90</u>
At 31 December	<u>4,881</u>	<u>-</u>	<u>4,881</u>	<u>1,562</u>	<u>-</u>	<u>1,562</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 20077 **OTHER BONDS**

Other bonds comprise:

	<u>Student loans</u>		<u>CDOs</u>		<u>Total</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
<u>Held-to-maturity – at amortised cost</u>						
Structured products	-	-	4,501	4,113	4,501	4,113
<u>Loans and receivables-at amortised cost</u>						
Structured products	<u>292</u>	<u>574</u>	<u>5,000</u>	<u>5,000</u>	<u>5,292</u>	<u>5,574</u>
Total other bonds	<u>292</u>	<u>574</u>	<u>9,501</u>	<u>9,113</u>	<u>9,793</u>	<u>9,687</u>

Other bonds classified as held-to-maturity and loans and receivables had a fair value of US\$ 4,470,000 and US\$ 4,646,500 respectively (31 December 2006: US\$ 4,094,500 and US\$ 4,699,000 respectively).

Structured products primarily comprise the Group's investments in asset securitisation programmes.

CDO bonds are secured by U.S. Government securities.

In the normal course of banking business, certain bonds are pledged to parties under repo agreements (Note 15). These bonds had a fair market value of US\$ 4.6 million as at 31 December 2007 (2006: US\$ 4.7 million).

Movements in other bonds were as follows:

	<u>Student loans</u>		<u>CDOs</u>		<u>Total</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
At 1 January	574	864	9,113	8,945	9,687	9,809
Amortized costs and others	-	-	204	168	204	168
Writeback for the year (Note 27)	-	-	184	-	184	-
Disposals (repayments received)	(290)	(357)	-	-	(290)	(357)
Foreign exchange movements	<u>8</u>	<u>67</u>	<u>-</u>	<u>-</u>	<u>8</u>	<u>67</u>
At 31 December	<u>292</u>	<u>574</u>	<u>9,501</u>	<u>9,113</u>	<u>9,793</u>	<u>9,687</u>

Other bonds are stated after deducting impairment provisions as follows:

	<u>2007</u>	<u>2006</u>
	US\$000	US\$000
At 1 January	11,834	11,834
Writeback for the year (Note 27)	<u>(184)</u>	<u>-</u>
At 31 December	<u>11,650</u>	<u>11,834</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 20078 **DERIVATIVE FINANCIAL INSTRUMENTS**

The Group utilised derivative instruments for trading purposes in 2007.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Group's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable and, thus the aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time. The fair values of derivative instruments held are set out in the following table:

	<u>Contract notional amount</u>		<u>Fair values</u>			
	<u>2007</u>	<u>2006</u>	<u>Assets</u>		<u>Liabilities</u>	
	<u>US\$000</u>	<u>US\$000</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Derivatives – held for trading						
<u>Equity derivatives</u>						
Equity options	<u>165</u>	=	<u>83</u>	=	=	=
Total	<u>165</u>	=	<u>83</u>	=	=	=

9 **LOANS AND ADVANCES**(a) **Composition**

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

	<u>Commercial</u>		<u>Government</u>		<u>Total</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	<u>US\$000</u>	<u>US\$000</u>	<u>US\$000</u>	<u>US\$000</u>	<u>US\$000</u>	<u>US\$000</u>
Americas	-	-	791	669	791	669
Rest of the world	<u>53</u>	<u>2,452</u>	<u>123</u>	<u>101</u>	<u>176</u>	<u>2,553</u>
Total loans and advances	<u>53</u>	<u>2,452</u>	<u>914</u>	<u>770</u>	<u>967</u>	<u>3,222</u>

Loans and advances are stated at cost less impairment provisions. Government loans include US\$ 914,000 (31 December 2006: US\$ 770,000) which are held for trading and carried at market value.

(b) **Movements in loans and advances**

The movements in loans and advances portfolio were as follows:

	<u>2007</u>	<u>2006</u>
	<u>US\$000</u>	<u>US\$000</u>
At 1 January	3,222	7,715
Additions	136	2,650
Disposals	(2,535)	(7,228)
Fair value transferred to income statement	72	48
Foreign exchange movements	<u>72</u>	<u>37</u>
At 31 December	<u>967</u>	<u>3,222</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

9 **LOANS AND ADVANCES (CONTINUED)**

(c) **Provisions for impairment on loans and advances**

Loans and advances are stated after deducting provisions for impairment, which are as follows:

2007	<u>Specific</u>	
	<u>2007</u> US\$000	<u>2006</u> US\$000
At 1 January	-	25,303
Amounts written off	-	(25,168)
Amount (released) for the year (Note 27)	<u>-</u>	<u>(135)</u>
At 31 December	<u>-</u>	<u>-</u>

(d) **Non-accrual loans**

	<u>Less than 6 months</u>		<u>Over 3 years</u>		<u>Total</u>	
	<u>2007</u> US\$000	<u>2006</u> US\$000	<u>2007</u> US\$000	<u>2006</u> US\$000	<u>2007</u> US\$000	<u>2006</u> US\$000
<u>Government</u>						
Americas	-	-	791	669	791	669
Rest of the world	<u>123</u>	<u>-</u>	<u>-</u>	<u>101</u>	<u>123</u>	<u>101</u>
Total non-accrual loans	<u>123</u>	<u>-</u>	<u>791</u>	<u>770</u>	<u>914</u>	<u>770</u>

(e) **Unrecognized contractual interest**

	<u>2007</u> US\$000	<u>2006</u> US\$000
	At 1 January	3,450
Amounts written off	(975)	(12,570)
Amounts unrecognized within the year	435	395
Foreign exchange movements	<u>259</u>	<u>116</u>
At 31 December	<u>3,169</u>	<u>3,450</u>

10 **INSTALMENT SALE RECEIVABLE**

During 1995, the Bank entered into an agreement to sell its investment in land in the State of Kuwait on an instalment sale basis for US\$ 43,200,000. As security, the Bank obtained a first mortgage on the land and any subsequent enhancements to the property. Under the terms of the instalment sale transaction, the Bank has no liability with regard to any future costs. During 1998, the Bank entered into a revised agreement with the customer to release the first mortgage on the land and replace it with a guarantee from a bank in Kuwait.

In June 2001, the Bank released the guarantee from the bank in Kuwait that secured the instalment sale receivable. In consideration for the release of the guarantee, the Bank obtained the right to set off the interest and principal amounts due under a US\$ 20,000,000 subordinated debt agreement dated 20 June 2001.

In June 2005 the US \$20,000,000 subordinated loan which provided credit support to the instalment sale receivable, was converted to equity. The Bank has obtained a corporate guarantee to secure this receivable.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200711 **FIXED ASSETS**

Fixed assets comprise:

<u>2007</u>	Freehold land and building	Other fixed assets	Total
	US\$000	US\$000	US\$000
At 1 January 2007			
Cost/valuation	12,599	6,664	19,263
Accumulated depreciation	<u>-</u>	<u>(6,467)</u>	<u>(6,467)</u>
Net book amount	<u>12,599</u>	<u>197</u>	<u>12,796</u>
Year ended 31 December 2007			
Opening net book amount	12,599	197	12,796
Exchange rate adjustments	-	2	2
Additions	27	175	202
Depreciation charge	(449)	(58)	(507)
Amounts derecognized	<u>(12,177)</u>	<u>-</u>	<u>(12,177)</u>
Closing net book amount	<u>-</u>	<u>316</u>	<u>316</u>
At 31 December 2007			
Cost/valuation	-	6,718	6,718
Accumulated depreciation	<u>-</u>	<u>(6,402)</u>	<u>(6,402)</u>
Net book amount	<u>-</u>	<u>316</u>	<u>316</u>
<u>2006</u>	Freehold land and building	Other fixed assets	Total
	US\$000	US\$000	US\$000
At 1 January 2006			
Cost/valuation	11,400	6,764	18,164
Accumulated depreciation	<u>(475)</u>	<u>(6,553)</u>	<u>(7,028)</u>
Net book amount	<u>10,925</u>	<u>211</u>	<u>11,136</u>
Year ended 31 December 2006			
Opening net book amount	10,925	211	11,136
Exchange rate adjustments	-	5	5
Revaluation reserve	2,042	-	2,042
Additions	21	42	63
Depreciation charge	<u>(389)</u>	<u>(61)</u>	<u>(450)</u>
Closing net book amount	<u>12,599</u>	<u>197</u>	<u>12,796</u>
At 31 December 2006			
Cost/valuation	12,599	6,664	19,263
Accumulated depreciation	<u>-</u>	<u>(6,467)</u>	<u>(6,467)</u>
Net book amount	<u>12,599</u>	<u>197</u>	<u>12,796</u>

The land and building was revalued in December 2006 at US\$ 12,600,000 (Note 21). The land and building are mortgaged in favour of the Bank's lenders (Note 16).

In October 2007, the Board of Directors decided to sell the freehold land and building. The Bank reclassified the freehold land and building from fixed assets to assets held for sale. In December 2007, the Bank signed a definitive sale agreement and recognized a receivable of US\$ 18.04 million (Notes 12 and 33).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

12 **OTHER ASSETS**

Other assets comprise:

	<u>2007</u> US\$000	<u>2006</u> US\$000
Accrued interest receivable	643	669
Management fees receivable	281	256
Receivables from assets sold (Note 33)	18,037	-
Receivable from investment fund managers	6,555	20,126
Prepayments	397	630
Other	<u>1,435</u>	<u>3,677</u>
Total other assets	<u><u>27,348</u></u>	<u><u>25,358</u></u>

Receivables from assets sold as at 31 December 2007 amounting to US\$ 18.04 million (2006: nil) represent proceeds receivable from the sale of the Bank's freehold land and building (Notes 11, 16 and 33).

Provisions for impairment

Other assets are stated after deducting provisions for impairment, which are as follows:

	<u>2007</u> US\$000	<u>Specific</u> <u>2006</u> US\$000
At 1 January	-	-
Amount charged for the year (Note 27)	<u>317</u>	<u>-</u>
At 31 December	<u><u>317</u></u>	<u><u>-</u></u>

13 **BANK DEPOSITS**

Deposits from banks comprise:

	<u>2007</u> US\$000	<u>2006</u> US\$000
Bank deposits	<u>10,015</u>	<u>-</u>
Total bank deposits	<u><u>10,015</u></u>	<u><u>-</u></u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200714 **CUSTOMER DEPOSITS**

Customer deposits comprise:

	<u>2007</u> US\$000	<u>2006</u> US\$000
Customer participation in funds	19,028	23,847
Government entities, corporates and individuals	<u>17,525</u>	<u>23,748</u>
Total customer deposits	<u>36,553</u>	<u>47,595</u>

Customer participation in funds represent amounts received from customers to be invested in private equity funds marketed by BMB and amounts from private equity realisations received by the Bank and not yet distributed to customers. These funds, although treated as part of customer deposits, are retained by the Bank until drawdowns are made by private equity fund managers or paid to the customers as part of realised distributions. Customer deposits carry market rates of interest for the period until drawdown or payment. Customer participation in funds includes US\$ 6,114,000 (31 December 2006: US\$ 9,511,000) in deposits held on behalf of BMB Technology and Telecommunications Fund (Note 36).

15 **SECURITIES SOLD UNDER REPURCHASE AGREEMENTS**

Securities sold under repurchase agreements ("Repos") comprise the following:

	<u>2007</u> US\$000	<u>2006</u> US\$000
Repos on other bonds (Note 7)	<u>3,700</u>	<u>3,700</u>
Total securities sold under repurchase agreements	<u>3,700</u>	<u>3,700</u>

16 **MEDIUM TERM LOAN**

The Bank raised an unsecured medium term loan facility of US\$ 75,000,000 on 21 December 1999, which was drawn on 18 January 2000. This loan carried interest at Libor plus 100 basis points and was repayable with a bullet repayment on 23 December 2002. The front-end fee paid was 145 basis points. The fee, together with all costs associated with this facility, was amortised over the life of the loan facility.

On 14 December 2004, the Bank and the lenders signed an agreement to refinance this facility. The refinancing agreement became effective as of 28 July 2005, after the fulfilment of certain conditions precedent including a US\$ 5,000,000 principal down payment, a mortgage in favour of the lenders on the Bank's head office land and building and establishment of a pledged account in connection with a mechanism under which 50% of the Bank's excess operating cash flow over a minimum cash balance threshold would be dedicated to debt service.

The refinancing bears interest at a rate of Libor plus 150 basis points. After the conversion on 30 August 2005 of US \$16,800,000 of this facility under the Bank's capital restoration plan, the loan balance was reduced to US \$53,200,000 with principal repayments of US \$9,500,000 (June 2006), US \$15,200,000 (June 2007) and US \$28,500,000 (June 2008). The instalments of US\$ 9,500,000 (due June 2006) and US\$ 15,200,000 (due June 2007) have been paid. A refinancing fee of 1% was paid and is being amortized over the life of the loan to maturity.

In late December 2007, the Bank sold its headquarters land and building with payment to be made in first quarter 2008. Accordingly, in order to protect the interests of the lenders under the medium term loan and as per agreement with the buyer, the mortgage in the lenders' favour on the Bank's headquarters land and building remains in place during this period. As per discussions with the lenders, they will release the mortgage upon the full prepayment of the loan, which will be funded by the sale proceeds and an additional payment by the Bank for the remaining amount (Notes 11, 12 and 33).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200717 **REVOLVING LOAN FACILITY**

	<u>2007</u> US\$000	<u>2006</u> US\$000
Revolving loan facility	<u>13,600</u>	<u>13,600</u>

On 30 December 2003, the Bank signed a US\$ 20,000,000 three-year revolving facility secured by certain of the Bank's investments in private equity funds/investments (Note 6). This facility was designed to provide liquidity to the Bank with applicable interest at floating US\$ Libor. By an amended agreement signed in December 2006, the facility was extended to 30 December 2007 with an interest rate of floating US\$ Libor plus 25 basis points.

In December 2007, an additional amendment agreement was signed, extending the facility to 30 June 2008, with a revised interest rate of floating US\$ Libor plus 80 basis points.

18 **OTHER LIABILITIES**

Other liabilities comprise:

	<u>2007</u> US\$000	<u>2006</u> US\$000
Accrued interest payable	839	763
Unclaimed dividends	3,387	3,405
Employee leaving indemnity (Note 29)	965	1,074
Accrued expenses	1,535	1,708
Other	<u>349</u>	<u>694</u>
Total other liabilities	<u>7,075</u>	<u>7,644</u>

19 **SUBORDINATED LOAN**

On 29 June 2001, the Bank raised a subordinated debt facility of US\$ 10,000,000 repayable on 29 December 2006 which was extended to December 2008. The debt carried interest at 13% per annum, 8% payable annually and the difference payable when realisation of profits on certain private equity investments of the Bank takes place (Notes 6 and 22).

On 1 November 2001, the interest payable on the above subordinated facility was amended to 8% per annum, 5% payable annually and the difference payable when realisation of profits on certain private equity investments of the Bank takes place (Notes 6 and 22).

20 **SHARE CAPITAL**

Share capital comprises:

	<u>2007</u>		<u>2006</u>	
	Number <u>000</u>	Amount US\$000	Number <u>000</u>	Amount US\$000
<u>Authorised</u>				
Ordinary shares of US\$0.25 each	<u>2,000,000</u>	<u>500,000</u>	<u>2,000,000</u>	<u>500,000</u>
<u>Issued and fully paid</u>				
Ordinary shares of US\$0.25 each				
At 1 January/31 December	<u>209,352</u>	<u>52,338</u>	<u>209,352</u>	<u>52,338</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200720 **SHARE CAPITAL (CONTINUED)**

A distribution of each class of equity security, setting out the number of holders and percentage in the following categories at 31 December:

Ordinary shares	2007			2006		
	No. of Shares	No. of Shareholders	% of Total Outstanding Shares	No. of Shares	No. of Shareholders	% of Total Outstanding Shares
Less than 1%	7,112,416	13,140	3.40%	7,112,416	13,139	3.40%
1% up to less than 5%	7,466,672	1	3.57%	7,466,672	1	3.57%
5% up to less than 10%	59,623,997	4	28.48%	59,623,997	4	28.48%
10% up to less than 20%	-	-	-	-	-	-
20% up to less than 50%	135,148,865	2	64.55%	135,148,865	2	64.55%
50% and above	-	-	-	-	-	-
	209,351,950	13,147	100%	209,351,950	13,146	100%

Treasury shares

At 31 December 2007, the Bank owned 1 of its own shares (31 December 2006: 1 share). This share is treated as a deduction from the shareholders' equity.

Earnings per share

Earnings per share is computed as below:

	Basic		Diluted	
	2007	2006	2007	2006
Net income	<u>US\$ 24,616,500</u>	<u>US\$ 21,115,000</u>	<u>US\$ 24,616,500</u>	<u>US\$ 21,115,000</u>
Weighted average number of shares	<u>209,351,949</u>	<u>209,351,949</u>	<u>209,351,949</u>	<u>209,351,949</u>
Earnings per share	<u>US\$ 0.12</u>	<u>US\$ 0.10</u>	<u>US\$ 0.12</u>	<u>US\$ 0.10</u>

21 **RESERVES**

The Group's reserves analysed in the consolidated statement of changes in equity comprise:

Legal reserve

Legal reserve comprises amounts set aside in accordance with the Bahrain Commercial Companies Law 2001, which requires that the Bank should make an annual transfer of a minimum of 10% of net profit for the year to a non-distributable legal reserve until such reserve equals 50% of its paid up share capital.

General reserve

General reserve comprises amounts set aside as a voluntary reserve from the profits of the Bank, upon the recommendation of the Board of Directors, and approved by the shareholders at the Ordinary General Meeting.

Retained earnings

Retained earnings represent distributable profits after transfer of amounts to statutory and general reserves.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200721 **RESERVES (CONTINUED)****Dividends**

Dividends are accounted once they have been ratified at the Ordinary General Meeting and the required regulatory approval has been obtained. At the meeting on 29 March 2008, a stock dividend of 5% for the year 2007 (2006: nil) is to be proposed.

Fair value reserve

Fair value reserve represents investment securities classified as available-for-sale. Income and losses arising from changes in the fair value of available-for-sale assets are recognised in the fair value reserve in equity.

Fixed asset revaluation reserve

Effective 30 September 2004, the Bank adopted a policy to revalue its land and building once every three years. Such revaluation is to be undertaken by an independent external valuer. In accordance with International Financial Reporting Standards, depreciation is provided on a straight-line basis over the remaining estimated useful life of the building calculated on the revalued amount. The assets are presented in the financial statements at their revalued amounts, being the fair value at the revaluation date less any subsequent accumulated depreciation. Land is not subject to depreciation.

At 30 September 2004, the land and building were fair valued based on open market valuation method, at US\$ 11,406,000 by a firm of an independent professional valuers. The net impact of revaluation US\$ 5,056,000 was credited to a fixed asset revaluation reserve, as part of shareholders' equity. The building was depreciated over its estimated useful life of 20 years from 1 October 2004. As part of its established policy, the Bank again revalued its land and building in December 2006, by an independent valuer using the same valuation method, at US\$ 12,600,000. The net impact of this revaluation, US\$ 2,042,000, was credited to the fixed asset revaluation reserve. The building was being depreciated over its estimated useful life of 20 years from 1 January 2007. In October 2007, the fixed asset revaluation of US\$ 7,098,000 was reversed as the Bank put the land and building up for sale and reclassified these assets to assets held for sale. In December 2007, the Bank sold these assets.

22 **INCOME FROM INVESTMENTS**

Income from investments comprises:

	<u>2007</u> US\$000	<u>2006</u> US\$000
Income/(loss) from managed funds – trading	5	(148)
(Loss)/income from quoted equities – trading	(1,295)	1,704
Income from sovereign debt and bonds – trading	72	173
Income from other equities and funds	23,923	24,908
Income from other bonds	1	73
(Loss) from derivatives	(39)	-
Dividend income	<u>506</u>	<u>484</u>
Total income from investments	<u>23,173</u>	<u>27,194</u>

23 **FOREIGN EXCHANGE TRANSLATION INCOME**

Foreign exchange translation income comprises:

	<u>2007</u> US\$000	<u>2006</u> US\$000
Foreign exchange translation income	<u>1,923</u>	<u>6,062</u>
Total foreign exchange translation income	<u>1,923</u>	<u>6,062</u>

BMB INVESTMENT BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

24 **FEES AND COMMISSIONS INCOME**

Fees and commissions income comprises:	<u>2007</u> US\$000	<u>2006</u> US\$000
Performance fees	1,859	2,000
Management fees	517	629
Placement fees	82	584
Others	<u>18</u>	<u>20</u>
Total fees and commissions income	<u>2,476</u>	<u>3,233</u>

25 **OTHER INCOME**

Other income comprises:	<u>2007</u> US\$000	<u>2006</u> US\$000
Net service fee income	54	47
Other (loss)/income	<u>(16)</u>	<u>160</u>
Total other income	<u>38</u>	<u>207</u>

Service fee income represents car park, cleaning and decor services to the BMB Centre tenants carried out by BMB Property Services.

26 **NET INTEREST (EXPENSE)**

Net interest (expense) comprises:	<u>2007</u> US\$000	<u>2006</u> US\$000
Interest income:		
Placement with banks	1,197	323
Government bonds and other bonds	482	465
Loans and advances	78	207
Instalment sale receivable	<u>948</u>	<u>1,021</u>
Total interest income	<u>2,705</u>	<u>2,016</u>
Interest expense:		
Deposits from banks	(78)	-
Customers deposits	(2,072)	(2,258)
Loan facilities	(4,268)	(4,928)
Securities sold under repurchase agreements	<u>(209)</u>	<u>(189)</u>
Total interest expense	<u>(6,627)</u>	<u>(7,375)</u>
Net interest (expense)	<u>(3,922)</u>	<u>(5,359)</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200727 **IMPAIRMENT PROVISIONS**

The specific provision charge comprises:

	<u>2007</u> US\$000	<u>2006</u> US\$000
Charge for other equities and funds (Note 6)	3,381	615
Charge for other assets (Note 12)	317	-
(Release) for loans and advances (Note 9)	-	(135)
(Writeback) for other bonds (Note 7)	<u>(184)</u>	<u>-</u>
Total charge for impairment provisions	<u>3,514</u>	<u>480</u>

28 **GENERAL AND ADMINISTRATIVE EXPENSES**

General and administrative expenses comprise:

	<u>2007</u> US\$000	<u>2006</u> US\$000
Salaries and other personnel expenses (Note 29)	6,650	6,316
Occupancy and equipment	347	464
Other	<u>1,739</u>	<u>2,511</u>
Total general and administrative expenses	<u>8,736</u>	<u>9,291</u>

29 **EMPLOYEE BENEFITS****Employee retirement benefits**

The costs associated with contributions made by the Bank towards the pension scheme for Bahraini nationals administered by the Government of the Kingdom of Bahrain amounted to US\$ 73,200 (31 December 2006: US\$ 67,000). The Kingdom of Bahrain pension scheme is a defined contribution plan, and accordingly the Bank has a legal and constructive obligation to pay the contributions as they fall due and no obligation exists to pay the future benefits.

The expatriate employees of the Group based in Bahrain are paid leaving indemnity in accordance with the Kingdom of Bahrain labour laws. The movement in leaving indemnity liability is summarised below:

	<u>2007</u> US\$000	<u>2006</u> US\$000
At 1 January	1,074	906
Accruals for the year	280	229
Paid during the year	<u>(389)</u>	<u>(61)</u>
At 31 December (Note 18)	<u>965</u>	<u>1,074</u>
	<u>2007</u> Number	<u>2006</u> Number
Employees at 31 December	<u>71</u>	<u>66</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200730 **RELATED-PARTY TRANSACTIONS AND BALANCES**

	Directors and key management personnel <u>2007</u> US\$000	Directors and key management personnel <u>2006</u> US\$000
Loans		
At 1 January	685	624
Advanced during the year	69	141
Repayments during the year	<u>(93)</u>	<u>(80)</u>
At 31 December	<u>661</u>	<u>685</u>
Administration charges for the year	<u>7</u>	<u>7</u>

No loans were advanced to any director of the Bank during the year or in 2006.

No provisions have been recognised in respect of loans given to related parties (31 December 2006: Nil).

The above loans are included as part of other assets.

The loans made to key management personnel are repayable monthly up to a period of three years. All loans are fully secured and bear an administration charge of 1% per annum (2006: 1% p.a.).

	Directors and key management personnel <u>2007</u> US\$000	Directors and key management personnel <u>2006</u> US\$000
Deposits		
At 1 January	57	95
Received during the year	1,735	340
Repaid during the year	(1,420)	(381)
Interest capitalised during the year	<u>4</u>	<u>3</u>
At 31 December	<u>376</u>	<u>57</u>
Interest expense on deposits for the year	<u>4</u>	<u>3</u>

Key management compensation

Compensation to key management personnel, including directors, was as follows:

	<u>2007</u> US\$ 000	<u>2006</u> US\$ 000
Salaries and other short-term employee benefits	2,680	2,254
Termination benefits	<u>108</u>	<u>109</u>
	<u>2,788</u>	<u>2,363</u>
Directors' remuneration	<u>387</u>	<u>347</u>

Directors' remuneration includes US\$ 300,000 (31 December 2006: US\$300,000) as proposed payment to be approved by the Ordinary General Meeting of shareholders scheduled for 29 March 2008.

30 **RELATED-PARTY TRANSACTIONS AND BALANCES (CONTINUED)**

Placement Transaction

During 2006, the Bank undertook a secondary offering of unlisted shares in a subsidiary of the Bank's major shareholder, earning US\$ 353,000 in placement fees. The terms and conditions for this placement were in line with those the Bank would have charged a non-related party for this service.

Guarantee

The Bank has received a corporate payment guarantee from Al Fawares with regard to the instalment sale receivable (Note 10).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200731 **INVESTMENTS IN SUBSIDIARIES****Listing of subsidiaries**

The principal subsidiaries of the Bank at 31 December were as follows:

<u>Subsidiaries</u>	<u>Ownership interest</u>		<u>Country of incorporation</u>	<u>Nature of business</u>
	<u>2007</u>	<u>2006</u>		
BMB Investment Company (Jersey) Limited	100%	100%	Jersey	Investment holding
Adhari Limited	100%	100%	Cayman Islands	Investment holding
BMB Property Services	100%	100%	Bahrain	Building Management
BMB Finance Limited	100%	100%	Cayman Islands	Investment holding
BMB-H Investment Company Limited	100%	100%	Channel Islands	Investment holding
BMB-H Investment Trading Limited	100%	100%	Cayman Islands	Investment holding
Universal Merchant Holdings NV	100%	100%	Netherlands Antilles	Investment holding
BMB Netherlands Antilles NV	100%	100%	Netherlands Antilles	Investment holding
BMB Curacao Netherlands NV	100%	100%	Netherlands Antilles	Investment holding
Universal Finance Holding NV	100%	100%	Netherlands	Investment holding
European Universal Finance NV	100%	100%	Netherlands	Investment holding
Beverages Limited	100%	100%	Channel Islands	Investment holding
Qassari Limited – LDC	100%	100%	Cayman Islands	Investment holding
Umm Shoam Limited – LDC	100%	100%	Cayman Islands	Investment holding
Bu Zaidan Limited – LDC	100%	100%	Cayman Islands	Investment holding
BMB SP Holdings Limited	100%	100%	Channel Islands	Investment holding
BMB New Era Ventures – I LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – II LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – III LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – IV LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – V LDC	100%	100%	Cayman Islands	Investment holding
BMB Ventures Limited	100%	100%	Cayman Islands	Investment holding
T&T Beverages Limited (T&T)	93.9%	93.9%	United Kingdom	Softdrinks
T&T Beverages Limited II	100%	100%	United Kingdom	Softdrinks

Effective 25 April 2006, T & T Beverages Limited was put into voluntary liquidation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

31 **INVESTMENTS IN SUBSIDIARIES (CONTINUED)**

T&T Beverages Limited II was created to hold certain intellectual property rights of T&T. It does not engage in operations.

With the exception of T&T Beverages, which is in liquidation, and BMB Property Services, the Bank's other subsidiaries are used solely to hold investments and do not engage in independent operations.

At 31 December all subsidiary companies were consolidated in the financial statements.

32 **LEGAL CLAIMS**

(a) Share issuance - 1982

The Bank and the Bank of Bahrain and Kuwait were co-defendants in a litigation in Kuwait arising in connection with the issuance of the original shares of BMB in 1982. In May 2002, the Court of First Instance in Kuwait ruled in favour of the Bank and its co-defendant. In April 2003, the Appellate Court upheld the judgement of the Court of First Instance ruling in the Bank's favour. The Kuwaiti litigant had the right to appeal to the Court of Cassation, but did not file a challenge within the stipulated time, and hence, the litigation in Kuwait came to a final conclusion in the Bank's favour.

On 10 August 2003, the Kuwaiti litigant filed suit in Bahrain. The case is pending in the courts of Bahrain having been adjourned several times, the latest being 29 November 2007. At the hearing held on 29 November 2007, the Court passed an interim judgement, whereby it appointed a Court Expert and required the plaintiff to pay the advance fee of the Expert. The plaintiff paid the fee on 28 January 2008 and the case is in progress.

Based on the nature of this action and a previous favourable decision in its favour in a similar case in Bahrain, the Bank believes that this case will be decided in its favour and accordingly, no provision has been made in the financial statements.

(b) Validity of Extra Ordinary General Meeting – May 2005

In February 2006, a shareholder of the Bank instituted a legal case in Bahrain challenging the validity of the Bank's Extra Ordinary General Meeting ("EGM") of shareholders held on 11 May 2005 and seeking to have the Bank placed under judicial receivership. In April 2006, the Court ruled in favour of the Bank, rejecting the plaintiff's request for receivership and in favour of the plaintiff in the matter of the Bank's EGM.

On 24 December 2006, the Court of Appeals rejected the appeals of the Bank and the shareholder.

On 25 January 2007, BMB filed an appeal with the Court of Cassation against the judgement of the Court of Appeals.

On 19 February 2007, the Court of Cassation agreed to hear BMB's appeal and filed a temporary stay of execution of the judgement of the Court of Appeals, pending the Court of Cassation's review and final judgement on BMB's appeal.

On 22 October 2007, the Court of Cassation annulled the judgement against BMB and rejected the plaintiff's case.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200733 **NET INCOME FROM ASSETS SOLD**

Net income from assets sold comprises:

	<u>2007</u> US\$000	<u>2006</u> US\$000
<u>Income</u>		
Profit on sale of freehold land and building	12,959	-
Rental income	867	875
Service charge income	<u>135</u>	<u>131</u>
	<u>13,961</u>	<u>1006</u>
<u>Expenses</u>		
Staff costs	222	221
Depreciation	449	389
Others	<u>111</u>	<u>137</u>
	<u>782</u>	<u>747</u>
Net income from assets sold	<u>13,179</u>	<u>259</u>
Net cash flow from assets sold:		
	<u>2007</u> US\$000	<u>2006</u> US\$000
Net profit from assets sold	13,179	259
<u>Additions:</u>		
Depreciation	449	389
Net book amount – freehold land and building (Note 11)	12,177	-
<u>Less:</u>		
Proceeds not received from sale of freehold land and building (Note 12)	(18,037)	-
Revaluation reserves released (Note 21)	<u>7,098</u>	<u>-</u>
Net cash flow provided by assets sold as at 31 December	<u>670</u>	<u>648</u>

In the fourth quarter of 2007, the Bank derecognized freehold land and building from fixed assets to assets sold.

In late December 2007, the Bank signed a definitive sale agreement with the buyer.

34 **FINANCIAL RISK MANAGEMENT**

In the normal course of its business, the Bank is exposed to various risks, related to the nature of the activities in which it engages. The principal sources of risk are credit risk, market risk, interest rate risk, currency risk, liquidity risk, private equity risk, operating risk and legal risk.

At BMB, the management of financial and other risks is based on the establishment of an appropriate risk governance structure, comprising:

- procedures for identification and quantification of risks
- criteria for risk acceptance based on risk and return as well as other factors
- clearly defined exposure and risk limits
- robust operating policies and procedures, including those for specific allocation of risk limits to individual obligors and/or transactions
- the use of quantitative models and qualitative approaches to assess and manage risks
- portfolio diversification and, where possible, other risk mitigation techniques
- ongoing review of exposures and risks by an independent department, including stress testing and frequent reporting
- periodic internal audits of the control environment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

34 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

Risk limits are at the heart of this process. BMB begins by setting maximum exposure limits as a percentage of capital for major lines of business. Within these macro limits, sublimits are set by geography, obligor type/credit grade, instrument, tenor, etc. For trading activities additional limits such as VaR, duration, maximum intraday and interday exposures, “stop losses” etc are applied as well. Individual transactions then take place within these sublimits.

Despite the existence of various risk limits, overall risk discipline is maintained by the requirement that the Bank (a) maintain a Basel I (and now Basel II) capital adequacy ratio in excess of the regulatory required minimum and (b) consider the impact on the Bank’s liquidity position of any major transaction(s) or new business initiative.

Risk management at BMB begins at the Board of Directors level. The Board of Directors exercises oversight and final approval of the risk management process at BMB. It operates through two Board Committees, the Executive Committee and the Audit Committee. With input provided by the Bank’s Risk Management Committee, the Executive Committee proposes the overall risk management strategy of the Bank. Based on the recommendations of the Executive Committee, the Board of Directors approves the aggregate levels of risk the Bank can assume as well as reviewing and approving the Bank’s risk management policies, risk limits and risk control framework. Among its duties, the Audit Committee is charged with reviewing and approving the Bank’s policies and procedures as well as overseeing both the internal and external audits of the Bank, including matters related to anti money laundering and anti terrorism finance.

The Board delegates certain authority to the Executive Committee and the executive management of the Bank to implement the risk control decisions of the Board. To carry out these responsibilities, executive management operates through a Risk Management Committee (the “RMC”).

The RMC is chaired by the Chief Executive and comprises members of senior management. It serves as the Bank’s credit committee, asset/liability management committee, and investment approval committee. In addition, it prepares and submits to the Board detailed risk control policies and procedures as well as country, asset class and individual counterparty limits for Board approval. On an ongoing basis, the RMC monitors the environment in which the Bank operates and the risks to which it is exposed and adjusts the Bank’s operations as appropriate.

The Risk Management Department (“RMD”) plays a key role in this process. The RMD is independent of the Bank’s trading and business areas and reports directly to the Chief Executive. It is responsible for identifying and quantifying risk exposures, recommending appropriate limits and monitoring usage of them. As part of its duties, the RMD prepares a variety of daily risk reports, including stress tests, for senior management and the RMC. In addition, the RMD manages problem or past-due assets.

Internal Audit which is independent of both operations and the Bank’s business units, also assist in the risk management process. In particular, Internal Audit is charged with a periodic review of the effectiveness of BMB’s policies and internal controls - a review which is independent of the Bank’s executive management.

As a further step in mitigating risks, the Bank follows a policy of diversification in its activities and seeks to minimise the risk exposure to particular geographical regions, counterparties and instruments and types of business. During fiscal year 2007, external factors have limited the Bank’s ability to fully implement this policy, particularly with respect to managing the foreign exchange exposure of the Bank’s investments.

In identifying and monitoring risk exposures, BMB uses a variety of quantitative tools (including Value at Risk) as well as qualitative approaches to measure risks at the “macro” level. The Bank seeks to judiciously balance the use of these two approaches rather than rely on a single approach.

The following sections review the principal risks to which the Bank is exposed in the normal course of its business and how it manages those risks.

34 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

Credit risk

Credit risk is the risk of loss arising as a result of the inability or unwillingness of a counterparty to meet its obligations to the Bank. The Risk Management Department, under the oversight of RMC, has the responsibility for establishing credit risk standards and implementing the Bank's credit risk management process.

BMB uses the standardized approach under the Basel framework for measuring and managing its credit risk.

The Bank estimates the probability of default through its risk grading system which employs a ten-grade scale, with "1" representing a risk which has the least probability of default (equivalent to AAA rating) and "10" representing a defaulted obligation (equivalent to rating below CCC-). Risk grading is based on (a) quantitative factors (historical and prospective such as cash flow, profitability, asset quality and tenor of risk), (b) qualitative factors (such as management quality, market share and competitive position) and other factors, including country risk, the type of transaction, tenor, and credit mitigation. Where ratings from an External Credit Assessment Institution, recognized by the Central Bank of Bahrain, are available, BMB considers these as part of its ratings process.

All obligors and countries are risk graded. All lines of credit, counterparty, country and trading limits are subject to annual reaffirmation by the Board of Directors. The limits are also reviewed more frequently as necessary to ensure consistency with the Bank's trading and investment strategies or to take into account latest market developments.

The Bank seeks to mitigate its exposure to losses through a variety of techniques such as investing in senior instruments (those with legal priority), transaction structuring and collateral or other security.

Given the nature of the Bank's business, the Bank uses nominal balance sheet amounts including accrued interest and other receivables as its measure of exposure. Credit risks for a given economic entity (including its subsidiaries and affiliates) are aggregated as the measure of exposure and are managed at that level. Credit standards are defined in the Bank's Credit Policies and Procedures Manual and include a sound process for evaluating obligor, transaction and product risks as well as concentration risk, etc.

The Group attempts to manage its credit risk exposure through diversification of its equity investments, capital markets, trading and lending activities. Where possible, collateral and other security are obtained.

In order to ensure a common approach to risk control, the Bank uses the same credit procedures when entering into trading activities, including FX and derivatives, as it does for traditional lending products. Master netting agreements and collateral arrangements as well as limits and the tenors of transactions are employed to further control risks.

Overall, Bank management considers that its policies and procedures constitute a reasonable approach to managing the credit risk in the activities it is engaged in.

With respect to specific assets, the following summarizes key credit risk issues:

- Cash and deposits are placed with major OECD and regional banks
- Government bonds comprise bonds received in settlement for an outstanding past due loan.
- Other bonds are secured by US Government securities except for a small amount of securitized student loans (UK).
- The instalment sales receivable is supported by an appropriate security package.

BMB is not engaged in retail business and therefore does not use credit "scoring" models. Nor has the Bank securitized any of its assets and therefore has no recourse obligations under such transactions. BMB does not have any exposure to "highly leveraged institutions" as defined by the Financial Stability Task Force.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200734 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

Concentration of credit risk arises when a number of obligors or 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. Accordingly, such concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or region.

The following tables summarize the Group's geographical and industry sector exposures, and any potential risk concentrations arising there from. Maximum credit risk exposures are detailed without considering the effects, if any, of collateral or other credit mitigation techniques on the Group's assets, liabilities and off balance sheet items.

(a) Geographical sector

	<u>North America</u>		<u>Europe</u>		<u>Rest of the world</u>		<u>Total</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
Assets								
Cash and deposits with banks	721	1,229	31,803	11,308	4,078	171	36,602	12,708
Government bonds	-	-	-	-	4,388	4,388	4,388	4,388
Other equities and funds	26,588	39,079	36,717	29,659	9,959	6,952	73,264	75,690
Other bonds	9,501	9,113	292	574	-	-	9,793	9,687
Derivative financial instruments	83	-	-	-	-	-	83	-
Loans and advances	791	669	-	-	176	2,553	967	3,222
Instalment sale receivable	-	-	-	-	18,839	20,311	18,839	20,311
Other assets	<u>3,953</u>	<u>2,204</u>	<u>2,987</u>	<u>19,368</u>	<u>20,408</u>	<u>3,786</u>	<u>27,348</u>	<u>25,358</u>
Total assets subject to credit risk	<u>41,637</u>	<u>52,294</u>	<u>71,799</u>	<u>60,909</u>	<u>57,848</u>	<u>38,161</u>	<u>171,284</u>	<u>151,364</u>
Trading equities and funds	273	4	6,505	6,556	2,501	1,946	9,279	8,506
Fixed assets	<u>-</u>	<u>-</u>	<u>70</u>	<u>69</u>	<u>246</u>	<u>12,727</u>	<u>316</u>	<u>12,796</u>
Reconciliation to total assets	<u>41,910</u>	<u>52,298</u>	<u>78,374</u>	<u>67,534</u>	<u>60,595</u>	<u>52,834</u>	<u>180,879</u>	<u>172,666</u>
Off-balance sheet credit and investment instruments	<u>9,822</u>	<u>5,335</u>	<u>22,073</u>	<u>30,276</u>	<u>-</u>	<u>-</u>	<u>31,895</u>	<u>35,611</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200734 **FINANCIAL RISK MANAGEMENT (CONTINUED)****(b) Industry sector**

(i) As at 31 December 2007

	<u>Banking/ Finance</u> <u>2007</u> US\$000	<u>Govern- ment</u> <u>2007</u> US\$000	<u>Technology/ Telecoms</u> <u>2007</u> US\$000	<u>Diversified</u> <u>2007</u> US\$000	<u>Others</u> <u>2007</u> US\$000	<u>Total</u> <u>2007</u> US\$000
Assets						
Cash and deposits with banks	36,536	66	-	-	-	36,602
Government bonds	-	4,388	-	-	-	4,388
Other equities and funds	-	-	19,001	50,487	3,776	73,264
Other bonds	-	9,501	-	-	292	9,793
Derivative financial instruments	60	-	23	-	-	83
Loans and advances	-	914	-	-	53	967
Instalment sale receivable	-	-	-	-	18,839	18,839
Other assets	<u>248</u>	<u>141</u>	<u>1,856</u>	<u>4,979</u>	<u>20,124</u>	<u>27,348</u>
Total assets subject to credit risk	<u>36,844</u>	<u>15,010</u>	<u>20,880</u>	<u>55,466</u>	<u>43,084</u>	<u>171,284</u>
Trading equities and funds	6,234	-	1,561	27	1,457	9,279
Fixed assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>316</u>	<u>316</u>
Reconciliation to total assets	<u>43,078</u>	<u>15,010</u>	<u>22,441</u>	<u>55,493</u>	<u>44,857</u>	<u>180,879</u>
Off-balance sheet credit and investment instruments	<u>-</u>	<u>-</u>	<u>6,368</u>	<u>25,527</u>	<u>-</u>	<u>31,895</u>
(ii) As at 31 December 2006						
	<u>2006</u> US\$000	<u>2006</u> US\$000	<u>2006</u> US\$000	<u>2006</u> US\$000	<u>2006</u> US\$000	<u>2006</u> US\$000
Total assets subject to credit risk	<u>12,842</u>	<u>14,455</u>	<u>20,999</u>	<u>71,289</u>	<u>31,779</u>	<u>151,364</u>
Total assets	<u>19,031</u>	<u>14,455</u>	<u>22,090</u>	<u>71,406</u>	<u>45,684</u>	<u>172,666</u>
Off-balance sheet credit and investment instruments	<u>-</u>	<u>-</u>	<u>1,993</u>	<u>33,618</u>	<u>-</u>	<u>35,611</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200734 **FINANCIAL RISK MANAGEMENT (CONTINUED)****Market risk**

Market risk is defined as potential adverse changes in the fair value or future cash flows of a trading position or portfolio of financial instruments resulting from the movement of market variables, such as interest rates, currency rates, equity and commodity prices, market indices as well as volatilities and correlations between markets.

As its primary tool, the Bank measures its market risk exposure using the standardized approach prescribed by the Basel Committee and the Central Bank of Bahrain.

BMB also uses RiskMetrics™ Value at Risk (“VaR”) model as a secondary market risk measurement and monitoring tool and as well for stress testing of positions. VaR is a statistical risk measure which quantifies within a given confidence level, the maximum expected fluctuation in the fair value of a portfolio within a specified time period. BMB calculates VaR for a 99% one-tailed confidence level for a one-day holding period based on market price changes during a previous one-year historical observation period. As such, the VaR parameters correspond to a maximum potential loss in one of one hundred trading days. The market data on which these calculations are made, including correlations and volatility, are provided by an independent third party vendor, Datametrics™. Calculations are made both by risk factor and then for the Bank’s entire market risk portfolio after consideration of correlations between asset classes which may result in diversification benefits or may reflect additional risk due to unfavorable co-movements between asset classes.

In addition to the estimation of daily VaR, the Bank conducts daily stress testing on its market risk portfolio for a variety of historical and simulated extreme market events. The Bank also performs stress tests on interest rate risk in its “banking book.” The results of these stress tests are reported to senior management as part of the daily VaR reports.

During 2007, the Bank’s trading activities were modest. Existing interest rate and foreign exchange exposures (the latter chiefly from foreign currency denominated private equity investments) as well as equity exposures from existing publicly traded equity investments are considered by the VaR model as market exposures.

The total 1-day VaR for these risks, segregated by the sources of risk, at 31 December were as follows:

VaR by source of risk

<u>Sources of risk</u>	<u>2007</u> US\$000	<u>2006</u> US\$000
Equity price risk	119	30
Interest rate risk	95	69
Foreign exchange rate risk	515	543
Less: Diversification benefit	<u>(160)</u>	<u>(110)</u>
Total VaR	<u>569</u>	<u>532</u>

The total VaR is less than the sum of the VaR of the individual risk components, due to diversification benefits arising from correlation within and across the risk classes.

During the year, the daily average total 1-day VaR, minimum total VaR and maximum total VaR were US\$ 480,388 (2006: US\$ 609,840), US\$ 407,493 (2006: US\$ 480,278) and US\$ 596,083 (2006: US\$ 994,921) respectively, estimated for 99% confidence level for a one day holding period.

As noted above, market risk arises from changes in various market variables, including interest rate and foreign exchange risk. The following tables provide information on the Bank’s interest rate and foreign currency risk exposures. The Bank does not have significant derivative positions, and, accordingly, no such information is provided.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

34 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

Interest rate risk

Interest rate risk is the risk that changes in market interest rates will affect (a) the fair value of financial instruments (“fair value interest rate risk”) and/or (b) the future cash flows associated with financial instruments subject to periodic repricing (“cash flow interest rate risk”). The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through a variety of means, such as the daily risk analysis reports from the market risk model which assist the management in measuring and monitoring the Bank’s exposure to interest rate risk.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

34 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

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

2007

	Up to <u>1 month</u> US\$000	1 – 3 <u>months</u> US\$000	3 - 6 <u>months</u> US\$000	6 - 12 <u>months</u> US\$000	1 – 5 <u>years</u> US\$000	Over <u>5 years</u> US\$000	Non- interest <u>bearing</u> US\$000	<u>Total</u> US\$000
Cash and deposits with banks	34,276	-	-	-	-	-	2,326	36,602
Trading equities and funds	-	-	-	-	-	-	9,279	9,279
Government bonds	-	-	-	-	-	4,388	-	4,388
Other equities and funds	-	-	-	-	-	-	73,264	73,264
Other bonds	292	-	-	-	-	9,501	-	9,793
Derivative financial instruments	-	-	-	-	-	-	83	83
Loans and advances	-	-	-	-	-	-	967	967
Instalment sale receivable	-	-	1,540	-	6,954	10,345	-	18,839
Fixed assets	-	-	-	-	316	-	-	316
Other assets	<u>2,366</u>	<u>19,894</u>	<u>513</u>	<u>514</u>	<u>3,813</u>	<u>-</u>	<u>248</u>	<u>27,348</u>
Total assets	<u>36,934</u>	<u>19,894</u>	<u>2,053</u>	<u>514</u>	<u>11,083</u>	<u>24,234</u>	<u>86,167</u>	<u>180,879</u>
Bank deposits	8,542	-	1,473	-	-	-	-	10,015
Customer deposits	36,066	-	-	-	-	-	487	36,553
Securities sold under repurchase agreements	3,700	-	-	-	-	-	-	3,700
Medium term loan	-	28,500	-	-	-	-	-	28,500
Revolving loan facility	13,600	-	-	-	-	-	-	13,600
Other liabilities	346	1,351	416	-	-	4,352	610	7,075
Subordinated loans	-	-	-	10,000	-	-	-	10,000
Shareholders' equity	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>71,436</u>	<u>71,436</u>
Total liabilities and shareholders' equity	<u>62,254</u>	<u>29,851</u>	<u>1,889</u>	<u>10,000</u>	<u>-</u>	<u>4,352</u>	<u>72,533</u>	<u>180,879</u>
Total interest rate sensitivity gap	<u>(25,320)</u>	<u>(9,957)</u>	<u>164</u>	<u>(9,486)</u>	<u>11,083</u>	<u>19,882</u>		
<u>2006</u>								
Total assets	<u>30,859</u>	<u>2,728</u>	<u>2,327</u>	<u>329</u>	<u>10,948</u>	<u>25,709</u>	<u>99,766</u>	<u>172,666</u>
Total liabilities and shareholders' equity	<u>66,270</u>	<u>44,144</u>	<u>413</u>	<u>286</u>	<u>13,405</u>	<u>1,074</u>	<u>47,074</u>	<u>172,666</u>
Total interest rate sensitivity gap	<u>(35,411)</u>	<u>(41,416)</u>	<u>1,914</u>	<u>43</u>	<u>(2,457)</u>	<u>24,635</u>		

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200734 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is a historical rate for a fixed rate instrument carried at fair value. The effective interest rate by major currencies for each of the monetary financial instruments which bear interest is as follows:

<u>2007</u>	Effective interest rate %		
	<u>US\$</u>	<u>GBP</u>	<u>EUR</u>
Assets			
Placements with banks	4.7	5.8	4.3
Government bonds	5.8	-	-
Other bonds	5.3	7.5	-
Loans and advances	-	-	-
Instalment sale receivable	4.8	-	-
Liabilities			
Bank deposits	-	-	4.4
Customer deposits	5.4	6.0	4.6
Securities sold under repurchase agreements			
Medium term loan	6.4	-	-
Revolving loan facility	5.4	-	-
Subordinated loan	8.0	-	-
<u>2006</u>			
	<u>US\$</u>	<u>GBP</u>	<u>EUR</u>
Assets			
Placements with banks	5.3	5.2	3.6
Government bonds	5.8	-	-
Other bonds	3.9	6.0	-
Loans and advances	7.9	-	-
Instalment sale receivable	4.8	-	-
Liabilities			
Bank deposits	-	-	-
Customer deposits	5.1	5.1	3.4
Securities sold under repurchase agreements	5.3	-	-
Medium term loan	6.9	-	-
Revolving loan facility	5.3	-	-
Subordinated loans	8.0	-	-

- (a) The effective interest rates are computed based upon a weighted average of the rates applicable to several individual instruments held at 31 December.
- (b) The effective interest rate for customer deposits has been computed excluding non-interest bearing accounts of US\$ 487,000 (31 December 2006: US\$ 647,000).
- (c) Statutory deposit held at the CBB is not included in the above.

Key to currencies:

US\$	-	United States Dollar
GBP	-	Great Britain Pound
EUR	-	Euro

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200734 **FINANCIAL RISK MANAGEMENT (CONTINUED)****Currency risk**

The Group is exposed to effects of fluctuations in the prevailing foreign currency exchange rates on its financial positions and cash flows. The table below summarises the Group's exposure to foreign currency exchange rate risk at 31 December in US\$ equivalent.

	<u>US\$</u> US\$000	<u>EUR</u> US\$000	<u>GBP</u> US\$000	<u>Others</u> US\$000	<u>Total</u> US\$000
Assets:					
Cash and deposit with banks	17,612	16,588	2,135	267	36,602
Trading equities and funds	694	5,727	778	2,080	9,279
Government bonds	4,388	-	-	-	4,388
Other equities and funds	29,034	28,170	12,041	4,019	73,264
Other bonds	9,501	-	292	-	9,793
Derivative financial instruments	83	-	-	-	83
Loans and advances	13	482	40	432	967
Instalment sale receivable	18,839	-	-	-	18,839
Fixed assets	246	-	70	-	316
Other assets	<u>5,080</u>	<u>1,991</u>	<u>877</u>	<u>19,400</u>	<u>27,348</u>
Total financial assets	<u>85,490</u>	<u>52,958</u>	<u>16,233</u>	<u>26,198</u>	<u>180,879</u>
Liabilities:					
Bank deposits	-	10,015	-	-	10,015
Customer deposits	29,878	4,370	2,291	14	36,553
Securities sold under repurchase agreement	3,700	-	-	-	3,700
Medium term loan	28,500	-	-	-	28,500
Revolving loan facility	13,600	-	-	-	13,600
Other liabilities	6,668	34	120	253	7,075
Subordinated loan	<u>10,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>10,000</u>
Total financial liabilities	<u>92,346</u>	<u>14,419</u>	<u>2,411</u>	<u>267</u>	<u>109,443</u>
Net on-balance sheet financial position	<u>(6,856)</u>	<u>38,539</u>	<u>13,822</u>	<u>25,931</u>	<u>71,436</u>
Off balance sheet commitments	<u>10,037</u>	<u>15,007</u>	<u>6,851</u>	<u>-</u>	<u>31,895</u>
<u>At 31 December 2006</u>					
Total financial assets	103,688	36,908	28,782	3,288	172,666
Total financial liabilities	<u>(117,999)</u>	<u>(4,689)</u>	<u>(2,700)</u>	<u>(851)</u>	<u>(126,239)</u>
Net on-balance sheet financial position	<u>(14,311)</u>	<u>32,219</u>	<u>26,082</u>	<u>2,437</u>	<u>46,427</u>
Off balance sheet commitments	<u>5,509</u>	<u>22,246</u>	<u>7,856</u>	<u>-</u>	<u>35,611</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

34 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

Liquidity risk

Liquidity risk is primarily the risk that the Bank will be unable to meet its payment obligations as they fall due and/or to replace funds when they are withdrawn (“liability liquidity risk”). It also represents the risk that the Bank will be unable to realize its assets in a timely fashion for prices close to their carrying values (“asset liquidity risk”).

BMB strives to minimise liability liquidity risk by diversifying its sources of funding across markets, instruments and counterparties, and by matching the maturity of liabilities to the maturity of assets. The Bank seeks to maintain high quality marketable securities within its portfolio as well as sizeable short-term deposits with banks as a cash reserve. Over the past years, the Bank has strengthened its liquidity position by refinancing its US\$ 75 million medium term facility, raising US\$ 52.34 million in additional capital, extending the maturity of the US\$ 20 million liquidity facility, and extending the maturity on the US\$ 10 million subordinated loan.

In its investing activities, BMB seeks to diversify its assets across instruments and markets and to avoid obligor concentrations which could constitute asset liquidity risk. This is particularly the case for our investments in unlisted private equity funds where BMB has consciously implemented a strategy of reducing our average individual investment size.

Liquidity is managed on a daily basis and senior management closely monitors significant daily changes to the liquidity position. In evaluating the liquidity position, the Bank also takes into account the possible call of undrawn commitments in its investment portfolio.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200734 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

The maturity profile of the Group's assets and liabilities is shown below:

2007

	<u>Within 1 month</u> US\$000	<u>1 - 3 months</u> US\$000	<u>3 - 6 months</u> US\$000	<u>6 - 12 months</u> US\$000	<u>1-5 years</u> US\$000	<u>5-10 years</u> US\$000	<u>10-20 years</u> US\$000	<u>Over 20 years</u> US\$000	<u>Total</u> US\$000
<u>Assets</u>									
Deposits with banks	36,648	-	-	-	-	-	-	-	36,648
Trading equities and funds	9,279	-	-	-	-	-	-	-	9,279
Government bonds	127	-	-	127	-	-	-	4,388	4,642
Other equities and funds	-	2,839	5,677	24,584	38,587	1,577	-	-	73,264
Other bonds	2	-	-	-	10,000	-	-	292	10,294
Derivative financial instruments	83	-	-	-	-	-	-	-	83
Loans and advances	53	914	-	-	-	-	-	-	967
Instalment sale receivable	-	-	2,457	-	12,286	9,403	-	-	24,146
Fixed assets	-	-	-	-	316	-	-	-	316
Other assets	<u>2,326</u>	<u>19,894</u>	<u>856</u>	<u>397</u>	<u>3,232</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>26,705</u>
Total assets	<u>48,518</u>	<u>23,647</u>	<u>8,990</u>	<u>25,108</u>	<u>64,421</u>	<u>10,980</u>	<u>-</u>	<u>4,680</u>	<u>186,344</u>
<u>Liabilities</u>									
Bank deposits	8,576	-	1,480	-	-	-	-	-	10,056
Customer deposits	22,073	797	797	3,107	10,117	-	-	-	36,891
Securities sold under repurchase agreements	3,717	-	-	-	-	-	-	-	3,717
Medium term loan	163	-	-	-	28,500	-	-	-	28,663
Revolving loan facility	64	-	13,600	-	-	-	-	-	13,664
Subordinated loan	-	-	800	10,400	-	-	-	-	11,200
Other liabilities	<u>6</u>	<u>1,268</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,962</u>	<u>-</u>	<u>-</u>	<u>6,236</u>
Total liabilities	<u>34,599</u>	<u>2,065</u>	<u>16,677</u>	<u>13,507</u>	<u>38,617</u>	<u>4,962</u>	<u>-</u>	<u>-</u>	<u>110,427</u>
Net liquidity gap	<u>13,919</u>	<u>21,582</u>	<u>(7,687)</u>	<u>11,601</u>	<u>25,804</u>	<u>6,018</u>	<u>-</u>	<u>4,680</u>	

Structured products (loans and receivables), included in other bonds, of US\$ 5,000,000 classified within the maturity band of 1 - 5 years is a marketable security readily convertible to cash secured by a U.S. Government security.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200734 **FINANCIAL RISK MANAGEMENT (CONTINUED)****2006**

	Within <u>1 month</u> US\$000	1 - 3 <u>months</u> US\$000	3 - 6 <u>months</u> US\$000	6 - 12 <u>months</u> US\$000	1-5 <u>years</u> US\$000	5-10 <u>years</u> US\$000	10-20 <u>years</u> US\$000	Over <u>20 years</u> US\$000	<u>Total</u> US\$000
<u>Assets</u>									
Deposits with banks	12,721	-	-	-	-	-	-	-	12,721
Trading equities and funds	8,506	-	-	-	-	-	-	-	8,506
Government bonds	127	-	-	-	-	-	-	4,388	4,515
Other equities and funds	-	11,365	8,553	21,168	16,189	18,415	-	-	75,690
Other bonds	4	-	-	-	10,000	-	-	574	10,578
Derivative financial instruments	-	-	-	-	-	-	-	-	-
Loans and advances	296	1,300	582	530	530	-	-	-	3,238
Instalment sale receivable	-	-	2,457	-	9,829	12,286	2,031	-	26,603
Fixed assets	-	-	-	-	197	-	12,599	-	12,796
Other assets	<u>17,161</u>	<u>2,728</u>	<u>329</u>	<u>329</u>	<u>4,119</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>24,666</u>
Total assets	<u>38,815</u>	<u>15,393</u>	<u>11,921</u>	<u>22,027</u>	<u>40,864</u>	<u>30,701</u>	<u>14,630</u>	<u>4,962</u>	<u>179,313</u>
<u>Liabilities</u>									
Bank deposits	-	-	-	-	-	-	-	-	-
Customer deposits	31,507	37	-	16,266	-	-	-	-	47,810
Securities sold under repurchase agreements	3,722	-	-	-	-	-	-	-	3,722
Medium term loan	-	-	15,950	-	28,500	-	-	-	44,450
Revolving loan facility	-	-	-	13,681	-	-	-	-	13,681
Subordinated loan	-	-	800	-	10,000	-	-	-	10,800
Other liabilities	<u>1,800</u>	<u>316</u>	<u>-</u>	<u>286</u>	<u>3,405</u>	<u>1,075</u>	<u>-</u>	<u>-</u>	<u>6,882</u>
Total liabilities	<u>37,029</u>	<u>353</u>	<u>16,750</u>	<u>30,233</u>	<u>41,905</u>	<u>1,075</u>	<u>-</u>	<u>-</u>	<u>127,345</u>
Net liquidity gap	<u>1,786</u>	<u>15,040</u>	<u>(4,829)</u>	<u>(8,206)</u>	<u>(1,041)</u>	<u>29,626</u>	<u>14,630</u>	<u>4,962</u>	<u>51,968</u>

Structured products (loans and receivables), included in other bonds, of US\$ 5,000,000 classified within the maturity band of 1-5 years is a marketable security readily convertible to cash secured by a U.S. Government security.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200734 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

The Bank's net liquidity position is summarised as follows:

<u>Detail</u>	<u>2007</u> US\$000	<u>2006</u> US\$000
Inter-bank placements and cash	36,602	12,708
Trading equities and funds	9,279	8,506
Other liquid bonds	5,000	5,000
Other assets	<u>19,240</u>	<u>—</u>
Total liquid assets	<u>70,121</u>	<u>26,214</u>
Bank deposits	(10,056)	-
Customer deposits maturing within 12 months	(27,138)	(31,329)
Medium term loan/due within 12 months	(28,663)	(15,200)
Repos on other bonds	(3,717)	(3,700)
Revolving loan facility	(13,664)	(13,600)
Subordinated loan	<u>(11,200)</u>	<u>—</u>
Total liquid liabilities	<u>(94,438)</u>	<u>(63,829)</u>
Net liquid position	<u>(24,317)</u>	<u>(37,615)</u>

Private equity risk

BMB invests in private equity with the intent of later sale of these investments at a profit to third parties either through a sale to another business ("trade sale") or an initial public offering ("IPO"). Private equity risk is the risk that the Bank will not be able to sell its investments at a profit within the intended time period. This risk arises from three factors. The first relates to the specific investment itself: that it does not develop a sustainable business or its line of business is not attractive to other investors. The second factor relates to macro trends in markets for IPO's and mergers and acquisition activity. The state of these markets affects both the price and timing of any "exit" from an investment. Third, as these investments typically are realised over the medium term and are not traded on organised exchanges, they have limited liquidity.

BMB uses the standardized approach under the Basel framework for measuring and managing its private equity risk, which is considered a part of its "banking book".

The Bank manages risks at the specific investment level in the following ways. First, it invests primarily in independently managed third party funds whose managers have a demonstrated successful track record. Based on its own experience and analysis of the private equity industry, BMB believes that the quality of the fund manager is a key risk mitigant. Second, the Bank seeks to diversify its investments across fund managers, different stages in the investment cycle (various stages of venture capital, buy-out, etc), geographical locations and industries. The goal is to reduce exposure to any one investment. At 31 December 2007, the Bank was effectively invested in over 1,485 companies (2006: 1,340) with an average investment size of US\$ 34,650 (2006: US\$ 62,000).

Trends in macro economic events and their effects on the IPO and trade sale market are largely out of the control of the Bank. BMB seeks to mitigate its exposure to these risks by selecting managers who have demonstrated a solid track record over the entire economic cycle and by diversification of investments. Diversification is also the key tool for dealing with the inherent limited liquidity of this asset class. In addition, from time to time, the Bank approaches leading investment banks to determine realistic market opportunities for the securitization of private equity assets.

As a result of a recent review, the Bank has decided to focus on private equity fund investment and minimize direct private equity investments.

Note 6 discusses private equity.

34 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

Operating and legal risk

Operating risk is the risk of loss arising from errors that can be made in instructing payments or settling transactions, breakdown in technology and internal control systems.

Beginning in 2008, BMB will use the basic indicator approach under the Basel framework for measuring and managing its operating risk.

Currently, the Bank conducts its business from a single location. BMB is an investment bank and does not operate a retail or commercial banking franchise. Accordingly, the number of client relationships and volume of transactions at BMB are lower than at such institutions. The nature of transactions differ as well given the Bank's focus on investing in unlisted private equities for its own and its clients' accounts. These factors mitigate to some extent the operational risks to which the Bank is exposed both in terms of volumes of transactions and the liquidity of the assets underlying these transactions (e.g., the Bank does not offer cash deposit/withdrawal services, ATMs, credit cards, etc).

BMB's operations are conducted according to well-defined procedures. These procedures include a comprehensive system of internal controls, including segregation of duties and other internal checks, which are designed to prevent either inadvertent staff errors or malfeasance prior to the release of a transaction.

The Bank also engages in subsequent monitoring of accounting records, periodic reconciliation of cash and securities accounts and other checks to enable it detect any erroneous or improper transactions which may have occurred.

Legal risk includes the risk of non-compliance with applicable laws or regulations, the illegality or unenforceability of counterparty obligations under contracts, and additional unintended exposure or liability resulting from the failure to structure transactions or contracts properly. Legal risks are mitigated through legal counsel review of transactions and documentation, as appropriate. Where possible, the Bank uses standard formats for transaction documentation.

To protect BMB from involvement in money laundering or terrorist finance activities, the Bank has designed and implemented a comprehensive set of policies and procedures. Adherence to the Bank's policies and procedures is reinforced through periodic staff training and internal and external reviews, as well as internal and external review by auditors.

To further mitigate operational and legal risks, the Bank purchases a variety of insurance.

35 **CAPITAL MANAGEMENT**

The primary purpose of the Bank's capital management is to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value.

To manage its capital, BMB employs a risk adjusted measure of capital adequacy (a capital adequacy ratio or "CAR") based on the local regulatory implementation of the Basel Committee on Banking Supervision's capital adequacy guidelines. During 2007 and for the prior fiscal year, BMB used the standards in the Basel 1988 Accord and 1996 Amendment for Market Risks.

The BMB Group manages its capital:

- (1) to comply at all times with the capital adequacy ratio set by the Group's regulator, the Central Bank of Bahrain
- (2) to ensure that the Bank has sufficient capital to enable it to absorb diminutions in the value of its assets or unexpected losses while continuing to function as a "going concern"
- (3) to maintain a sound capital base that allows the Bank to take advantage of opportunities to develop and grow its business.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200735 **CAPITAL MANAGEMENT (CONTINUED)**

The Group's executive management monitors the Bank's capital adequacy on a daily basis using the CAR. This is supplemented by use of RiskMetrics™ VaR program to assess market exposure and to perform stress tests of market positions and interest rate risk in the banking book. Reports on the Bank's capital adequacy are filed quarterly with the Central Bank of Bahrain.

As the Bank has no operating branches or subsidiaries outside the Kingdom of Bahrain, it is subject only to the capital requirements of the Central Bank of Bahrain, which currently requires all financial institutions in Bahrain to maintain a 12.0% CAR.

In determining its Capital Adequacy Ratio, the Bank calculates risk adjusted assets which are then divided by regulatory capital rather than the equity capital appearing in the Bank's balance sheet.

Regulatory equity capital is composed of two elements:

Tier 1 Capital is the nominal value of paid in capital, audited retained earnings and accumulated reserves arising from the appropriation of current and past years' income and/or retained earnings less any treasury stock, minority interests, or negative fair value reserves. Local regulations require that certain investments or exposures be deducted from Tier 1 capital. As of 31 December 2007 and 31 December 2006, BMB did not have any exposures or investments requiring such deductions.

Tier 2 Capital consists of the qualifying portion of subordinated loans and unrealized gains arising on fair valuation. Under Central Bank of Bahrain regulations, the aggregate amount of Tier 2 capital eligible for inclusion in the CAR is limited to no more than 100% of Tier 1 Capital.

At 31 December 2007 the capital adequacy ratio using the standardized approach was 31.36% compared to 20.22% at 31 December 2006, computed using the standardized approach for market risk weighted assets and for the credit risk weighted assets based on the BIS 1988 Capital Accord and 1996 amendments.

Capital base and risk weighted assets

	Average for the year <u>2007</u> US\$000	At year- end <u>2007</u> US\$000	Average for the year <u>2006</u> US\$000	At year- end <u>2006</u> US\$000
<u>Tier 1 capital</u>				
Share capital	52,338	52,338	52,338	52,338
Legal reserves	14,464	16,310	12,291	13,848
General and other reserves	10,138	10,138	10,138	10,138
Retained earnings	<u>(27,840)</u>	<u>(18,599)</u>	<u>(52,124)</u>	<u>(40,575)</u>
Total qualifying Tier 1 capital	<u>49,100</u>	<u>60,187</u>	<u>22,643</u>	<u>35,749</u>
<u>Tier 2 capital</u>				
Revaluation reserves – available for sale investments	10,272	11,249	895	3,580
Fixed assets revaluation reserves	5,324	-	10,903	7,098
Subordinated loan	<u>2,257</u>	-	<u>4,754</u>	<u>3,989</u>
Total qualifying Tier 2 capital	<u>17,853</u>	<u>11,249</u>	<u>16,552</u>	<u>14,667</u>
Total regulatory capital	<u>66,953</u>	<u>71,436</u>	<u>39,195</u>	<u>50,416</u>
<u>Risk weighted assets</u>				
On balance sheet	213,514	207,440	222,839	223,330
Off balance sheet	<u>23,663</u>	<u>20,374</u>	<u>23,516</u>	<u>25,993</u>
Total risk weighted assets	<u>237,177</u>	<u>227,814</u>	<u>246,355</u>	<u>249,323</u>
Capital Adequacy Ratio	<u>28.23%</u>	<u>31.36%</u>	<u>15.91%</u>	<u>20.22%</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

35 **CAPITAL MANAGEMENT (CONTINUED)**

On 1 January 2008, the Kingdom of Bahrain implemented Basel II. Using the Basel II standardized approaches for credit and market risk as well as the basic indicator approach for operational risk, BMB's Basel II capital adequacy ratio as of this date stood at 24.0%.

36 **OFF BALANCE SHEET ITEMS**

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

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

Standby letters of credit, guarantees and acceptances commit the Bank to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

Undrawn investment commitments comprise contractual commitments to make investments in quoted equities and in other equities and funds as amounts are called by fund managers. Commitments to other equities and funds are generally for a period of between four and six years.

The outstanding off balance sheet items at 31 December were as follows:

	<u>2007</u>	<u>2006</u>
	US\$000	US\$000
Undrawn investment commitments in other equities and funds (Note 6)	31,895	35,611
Funds under management	41,320	41,981
Discretionary accounts	90,311	78,524

Undrawn investment commitments in other equities and funds include US\$ 11,521,000 (31 December 2006: US\$ 9,618,000), which the Bank has sold to clients and for which it has received binding commitments from them, the majority of which are secured by deposits with the Bank.

BMB Technology and Telecommunications Investment Company was the only fund under management as at 31 December 2007. Discretionary accounts include funds managed on behalf of customers pertaining to sub-participation in other private equity funds, unquoted equities and other debt instruments.

37 **FAIR VALUE OF FINANCIAL INSTRUMENTS**

The table below compares the estimated fair values of on and off-balance sheet financial instruments with their respective book amounts as of 31 December 2007 and 2006. As set out in Note 2 to the financial statements, certain of the bank's financial instruments are accounted for under the historical cost convention as modified by the revaluation of available-for-sale financial assets, all derivative contracts and financial assets and financial liabilities held for trading which may differ from the fair value for which the asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Consequently differences can arise between book amounts and the fair value estimates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200737 **FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)**

<u>2007</u>	<u>Book amount</u>	<u>Fair value</u>	<u>Over/(under)</u>
	US\$000	US\$000	book amount
			US\$000
<u>Assets</u>			
Government bonds	4,388	2,927	(1,461)
Other bonds carried at amortised cost	9,793	9,262	(531)
Loans and advances	967	967	-
Instalment sale receivable	18,839	18,839	-
Net shortfall of fair value over book amount			<u>(1,992)</u>
<u>2006</u>	<u>Book amount</u>	<u>Fair value</u>	<u>Over/(under)</u>
	US\$000	US\$000	book amount
			US\$000
<u>Assets</u>			
Government bonds	4,388	2,863	(1,525)
Other bonds carried at amortised cost	9,687	8,794	(893)
Loans and advances	2,452	2,452	-
Instalment sale receivable	20,311	20,311	-
Net shortfall of fair value over book amount			<u>(2,418)</u>

The total shortfall in fair value of US\$ 1,992,000 (2006: US\$ 2,418,000) is not relevant except in a forced sale situation since the Bank has the intention and the ability to hold these bonds to maturity when it would recover the nominal amounts.

The total fair value of Government bonds and other bonds is based on quoted market prices at the balance sheet date.

The fair value of loans and advances, excluding loans held for trading purposes, is based on amounts estimated to be received upon maturity.

The fair value of the instalment sale receivable is shown at cost which approximates the value calculated using the discounted cash flow method.

No fair value adjustment is appropriate for off-balance sheet financial instruments with contractual amounts representing credit risk as specific provisions are made in respect of individual transactions where a potential loss, if any, has been identified.

The estimated fair value of the following assets and liabilities is not significantly different from the corresponding book amounts as the items are short term in nature:

- Cash and deposits with banks
- Other assets
- Bank deposits
- Customer deposits
- Securities sold under repurchase agreements
- Other liabilities

The estimated fair values of the medium term loan and the revolving loan facility are not significantly different from book amounts as these liabilities are primarily repriced on a monthly basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

38 **SEGMENT INFORMATION**

(a) **Business Segments**

The Group is organised into two business segments; banking and manufacturing. The banking segment has three sub-segments, trading, investment activity and other operations.

Trading activity - current investments in equities and funds and other derivative instruments.

Investing activity - investments in bonds, other equities and funds and hedging activity.

Other operations include investor marketing, building rental, etc.

Manufacturing: softdrinks

Transactions between business subsegments are on normal terms and conditions. The allocation of costs for each business segment is based on estimated time and relevant measurement criteria for each business segment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200738 **SEGMENT INFORMATION (CONTINUED)**

	<u>Banking</u>				<u>Manufacturing</u>	<u>Total</u>
	<u>Trading activity</u>	<u>Investing activity</u>	<u>Other operations</u>	<u>Total Banking</u>		
	<u>US\$000</u>	<u>US\$000</u>	<u>US\$000</u>	<u>US\$000</u>	<u>US\$000</u>	<u>US\$000</u>
<u>2007</u>						
Income from investments	(851)	24,024	-	23,173	-	23,173
Foreign exchange translation income	1,923	-	-	1,923	-	1,923
Fees and commissions income	-	-	2,476	2,476	-	2,476
Other income	-	-	58	58	(20)	38
Net interest income	<u>-</u>	<u>(3,926)</u>	<u>-</u>	<u>(3,926)</u>	<u>4</u>	<u>(3,922)</u>
Total income from operations	<u>1,072</u>	<u>20,098</u>	<u>2,534</u>	<u>23,704</u>	<u>(16)</u>	<u>23,688</u>
Impairment provisions	-	(3,514)	-	(3,514)	-	(3,514)
General and administrative expenses	<u>(43)</u>	<u>(5,975)</u>	<u>(2,718)</u>	<u>(8,736)</u>	<u>-</u>	<u>(8,736)</u>
Total operating expenses	<u>(43)</u>	<u>(9,489)</u>	<u>(2,718)</u>	<u>(12,250)</u>	<u>-</u>	<u>(12,250)</u>
Net income from operations	1,029	10,609	(184)	11,454	(16)	11,438
Net income from assets sold	<u>-</u>	<u>13,179</u>	<u>-</u>	<u>13,179</u>	<u>-</u>	<u>13,179</u>
Net income before taxation	1,029	23,788	(184)	24,633	(16)	24,617
Taxation	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net income for the year	<u>1,029</u>	<u>23,788</u>	<u>(184)</u>	<u>24,633</u>	<u>(16)</u>	<u>24,617</u>
<u>OTHER INFORMATION</u>						
Segment assets	10,277	168,489	-	178,766	81	178,847
Unallocated corporate assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,032</u>	<u>-</u>	<u>2,032</u>
CONSOLIDATED TOTAL ASSETS	<u>10,277</u>	<u>168,489</u>	<u>-</u>	<u>180,798</u>	<u>81</u>	<u>180,879</u>
Segment liabilities	-	102,225	-	102,225	143	102,368
Unallocated corporate liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,075</u>	<u>-</u>	<u>7,075</u>
Total liabilities	<u>-</u>	<u>102,225</u>	<u>-</u>	<u>109,300</u>	<u>143</u>	<u>109,443</u>
Shareholders' equity						<u>71,436</u>
CONSOLIDATED TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY						<u>180,879</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 200738 **SEGMENT INFORMATION (CONTINUED)**

	<u>Banking</u>			<u>Total Banking</u>	<u>Manufacturing</u>	<u>Total</u>
	<u>Trading activity</u>	<u>Investing activity</u>	<u>Other operations</u>			
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
<u>2006</u>						
Income from investments	1,971	25,223	-	27,194	-	27,194
Foreign exchange translation income	6,062	-	-	6,062	-	6,062
Fees and commissions income	-	-	3,233	3,233	-	3,233
Other income	-	-	421	421	(214)	207
Net interest income	<u>-</u>	<u>(5,360)</u>	<u>-</u>	<u>(5,360)</u>	<u>1</u>	<u>(5,359)</u>
Total income from operations	<u>8,033</u>	<u>19,863</u>	<u>3,654</u>	<u>31,550</u>	<u>(213)</u>	<u>31,337</u>
Impairment provisions	-	(480)	-	(480)	-	(480)
General and administrative expenses	<u>-</u>	<u>(5,602)</u>	<u>(2,675)</u>	<u>(8,277)</u>	<u>(1,014)</u>	<u>(9,291)</u>
Total operating expenses	<u>-</u>	<u>(6,082)</u>	<u>(2,675)</u>	<u>(8,757)</u>	<u>(1,014)</u>	<u>(9,771)</u>
Net income from operations	8,033	13,781	979	22,793	(1,227)	21,566
Net income from assets sold	<u>-</u>	<u>259</u>	<u>-</u>	<u>259</u>	<u>-</u>	<u>259</u>
Net income before taxation	8,033	14,040	979	23,052	(1,227)	21,825
Taxation	<u>-</u>	<u>(710)</u>	<u>-</u>	<u>(710)</u>	<u>-</u>	<u>(710)</u>
Net income for the year	<u>8,033</u>	<u>13,330</u>	<u>979</u>	<u>22,342</u>	<u>(1,227)</u>	<u>21,115</u>
<u>OTHER INFORMATION</u>						
Segment assets	9,275	158,521	-	167,796	307	168,103
Unallocated corporate assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,563</u>	<u>-</u>	<u>4,563</u>
CONSOLIDATED TOTAL ASSETS	<u>9,275</u>	<u>158,521</u>	<u>-</u>	<u>172,359</u>	<u>307</u>	<u>172,666</u>
Segment liabilities	-	118,595	-	118,595	407	119,002
Unallocated corporate liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,237</u>	<u>-</u>	<u>7,237</u>
Total liabilities	<u>-</u>	<u>118,595</u>	<u>-</u>	<u>125,832</u>	<u>407</u>	<u>126,239</u>
Shareholders' equity						<u>46,427</u>
CONSOLIDATED TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY						<u>172,666</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AT 31 DECEMBER 2007

38 **SEGMENT INFORMATION (CONTINUED)**

(b) **Geographical Segments**

	<u>North America</u>		<u>Europe</u>		<u>Rest of the world</u>		<u>Total</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
Income								
Total operating income	<u>15,616</u>	<u>8,802</u>	<u>10,407</u>	<u>20,469</u>	<u>(2,335)</u>	<u>3,072</u>	<u>23,688</u>	<u>32,343</u>
Assets								
Total assets	<u>41,910</u>	<u>52,298</u>	<u>78,374</u>	<u>67,534</u>	<u>60,595</u>	<u>52,834</u>	<u>180,879</u>	<u>172,666</u>

Although the Group's two main business segments are managed on a worldwide basis, they operate in two main geographical areas. The Group's exposure to credit risk is concentrated in these areas:

North America - United States of America and Canada
Europe - United Kingdom, Germany and France

39 **COMPARITIVE AMOUNTS**

Certain comparative figures have been reclassified to correspond with the presentation in the financial statements at 31 December 2007.