BMB INVESTMENT BANK

ANNUAL REPORT
FOR THE YEAR ENDED
31 DECEMBER 2006

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

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 to engage in offshore banking under a licence granted by the Bahrain Monetary Agency.

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 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 G7 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 submit the Bank's annual report for the year ended 31 December 2006.

2006 was a year of tremendous progress at BMB. Our net profit rose by 243% and was the second best in the Bank's history as we continued to work hard at rebuilding our franchise and securing our future prosperity. In addition to a strong set of financial results, the Bank made further advances in 2006 in distribution, deal flow, reputation building and expansion of our client base – all of which provide the firm foundation for building a sustainable banking franchise for the years to come.

BMB reported consolidated net profit of US$ 21.11 million, a 243% increase over 2005's restated net profit of US$ 6.16 million. Once again earnings from our private equity funds portfolio were the major component of revenues. BMB has over ten years successful experience as an investor in this asset class and going forward we expect strong returns from this portfolio. We recorded US$ 6.06 million in foreign exchange translation gains for 2006 as compared to US$ 5.32 million loss for 2005. Our foreign exchange earnings are subject to volatility due to insufficient foreign exchange and trading lines to hedge our non-US Dollar denominated assets, chiefly private equity investments.

Turning to our balance sheet, year over year, our Shareholders' Equity increased from US$ 27.25 million in 2005 to US$ 46.43 million in 2006, a 70% increase due solely to internally generated profitability and funds. Our capital adequacy ratio improved from 13.25% to 20.22%.

In last year's Directors' Report, we outlined the various steps we had taken to strengthen the liability side of our balance sheet, and thus provide a sound basis for moving BMB forward.

In 2006, we built on that foundation by taking several initiatives to enhance our revenue generation.

- We strengthened our marketing department by bringing on board new and experienced marketing officers to increase both the depth and scope of our market coverage. This, coupled with an increase in the tempo of our marketing campaign, has led to the development of new customer relationships throughout the GCC.

- We continued to develop the range of investment products offered to our clients. Following on the successful private placement of common equity in a US company earlier in the year, we launched a similar offering in the fourth quarter. We plan additional such offerings in 2007 as well as to begin marketing a global Shari'ah compliant fund of funds managed by a well respected US based investment company.

- We also made concrete progress in restoring counterparty trading facilities by securing FX trading facilities. We are confident that we will be able to obtain additional facilities in 2007 as we continue to demonstrate the underlying strength of our business.

In addition, we reduced the refinanced US$ 75 million medium term facility by an additional US$ 9.50 million payment, leading to a cumulative 42% reduction in this borrowing over a 17 month period.

Through all the difficulties and challenges of the last few years we remained determined not to lose sight of our long-term strategic plan and focus. Our confidence has clearly paid off.

Going forward, we will continue to focus on private equity investments and to grow our client business through enhancements to our Marketing Department and product slate. In regard to the latter, we will further develop our corporate finance private placement business. We believe that our client business and private placement businesses, which are less sensitive to market movements, will enable us to reduce volatility in our earnings. On a more limited basis, BMB will engage in proprietary trading of foreign exchange, equities, bonds and other interest rate sensitive instruments as we secure additional counterparty trading lines.

The Board is currently considering a variety of options to further strengthen the financial position of the Bank, including but not limited to, an increase in the share capital of the Bank.

Reflecting on 2006, we would like to thank His Majesty the King, the Government of Bahrain, the Central Bank of Bahrain and the many parties who contributed to our success.

We would like to express our appreciation to our business partners – investment and commercial banks, private equity fund managers, other finance industry professionals and our clients – as well as our shareholders, Board of Directors and our staff. The past few years have tested and proven these relationships in a way that less difficult circumstances would not have. Accordingly, our thanks are not just for usual business co-operation but to all those who stood with us during this challenging period. We look forward to continuing our working relationships with all of them in 2007 and beyond.

Wilson S. Benjamin
Chairman

Sheikh Abdulla A.K. Al Sabah
Vice Chairman

Albert I. Kittaneh
Chief Executive

03 February 2007

BMB Board of Directors and Board Committees

<u>Board of Directors</u>

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

<u>Executive Committee</u>

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

<u>Audit Committee</u>

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

<u>Notes:</u>

(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. During 2006, the Board selected Mr. Alwaleed Kamal to replace Mr. Abdulaziz A. Abdulmalik. In January 2007, the Bank completed the Central Bank of Bahrain review process for Mr. Kamal, who thereafter joined the Board. Mr. Nampalli joined the Board in July 2006.

(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 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 serve 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 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 Company, 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 U.S., Europe and the Gulf States. Since 2003, Chairman of Lotus Real Estate Company, a real estate development company in Egypt, and Board Member of Authentium, a company in the security software industry based in the 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 Member of the Executive Committee

Prior to his election as Vice Chairman in March 2006, Sheikh Abdulla was a member of the Board of Directors. A member of the Ruling Family of the State of Kuwait, Sheikh Abdulla is the Chairman of Lotus Air, a charter airline company in Egypt, Managing Director of Lotus Real Estate Development Company, 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 Masters 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 from 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, U.K.

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. Albert I. Kittaneh
Chief Executive

Over thirty one 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 of Securities Investment Company, Bahrain, a Board Member of Oryx Capital International Ltd., Saudi Arabia and MAK Holdings (Lebanon) and a member of the executive committee of the board 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, this 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 2006, 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 Tech, 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 2006, due to the lack of sufficient counterparty trading lines, 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. As well, 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.

SUMMARY OF FINANCIAL PERFORMANCE 31 DECEMBER 1996 – 2006

The key financial ratios from 31 December 1996 - 2006 are summarised as follows:

ILLUSTRATION 1
SUMMARY OF FINANCIAL DATA 1996-2006
(all figures in thousands of US dollars)

	2006	Restated 2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Net income/(loss) - as reported	21,115	6,165	594	(12,754)	(50,786)	(15,647)	(56,985)	30,085	13,711	18,658	9,493
Add/(deduct):loss/(profit) from discontinued operations	-	-	-	-	-	-	-	-	9,951	(5,081)	(2,597)
Net income/(loss) from continuing operations	21,115	6,165	594	(12,754)	(50,786)	(15,647)	(56,985)	30,085	23,662	13,577	6,896
Growth/(decline) in net income (%)	242.5%	937.9%	104.7%	74.9%	(224.6%)	72.5%	(289.4%)	27.1%	74.3%	96.9%	126.8%
Total shareholders' Equity	46,427	27,248	(27,777)	(28,085)	(20,874)	43,170	65,455	131,488	108,741	102,121	105,822
Total assets	172,666	168,411	182,004	180,695	190,548	512,833	622,620	655,579	739,195	751,533	645,036
Return on average shareholders' equity (%)	57.3%	N/A	N/A	N/A	(455.6%)	(28.8%)	(57.9%)	25.1%	23.7%	14.2%	7.1%
Return on average assets (%)	12.4%	3.5%	0.3%	(6.9%)	(14.4%)	(2.8%)	(8.9%)	4.4%	3.2%	2.0%	1.3%
Operating expenses/total income (%)	31.0%	48.2%	N/A	N/A	N/A	N/A	N/A	28.0%	27.4%	40.6%	39.9%
Average net income/ (loss) per employee	319	95	9	(196)	(794)	(216)	(712)	421	376	238	134
Financial leverage (times)	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	5.3:1
Net liquid position (US$ mill.)	(38)	(35)	(107)	(98)	(77)	(47)	45	64	70	51	(36)

The effects of prior period adjustments have not been reflected for periods earlier than 2005 (note 37).

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 provides an overview of the Bank's internal policies and procedures. As well, it analyzes BMB's financial performance for the year ended 31 December 2006 compared to 2005.

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.

COMPLIANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS

BMB's accounting policies are set out in note 2 to the financial statements and are in conformity with International Financial Reporting Standards.

INTERNAL FINANCIAL CONTROL AND CORPORATE GOVERNANCE

The Bank has designed and implemented procedures for safeguarding assets against unauthorised use or disposition, the maintenance of proper accounting records and the integrity of financial information both for internal use and external publication. These include measures to enhance effective internal financial and operational controls, including appropriate segregation of incompatible duties.

- Authority to operate the Bank and its various subsidiaries is delegated to the Chief Executive of the Bank within limits set by the Executive Committee and approved by the Board of Directors. Any transactions exceeding these limits require the concurrence of first, the Executive Committee and, then ratification by the Board of Directors. The appointment and removal of executives to and from the most senior positions (Senior Vice President and above) within the Bank requires the formal approval of the Board of Directors. Functional operating and financial reporting standards are also approved by the Board of Directors.

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

- The Bank's Management Committee is composed of members of the RMC and the functional division heads. The Management Committee serves as a forum for the discussion of the Bank's overall strategy, product development, marketing, and other significant business issues. As situations require, working groups composed of Management Committee members are tasked with studying specific issues and recommending actions for executive management approval.

- The Bank's Internal Audit function monitors compliance with policies and procedures and the effectiveness of internal controls. In designing and conducting its work, Internal Audit uses a risk based approach. Internal Audit submits its reports directly to the Audit Committee of the Board and the internal auditors conduct their work independently of the Bank's senior management. In 2006, the Bank outsourced its internal audit function to an internationally reputed firm after receiving CBB approval.

- To oversee and administer its anti-money laundering and anti-terrorism finance policies and procedures, with the concurrence of the CBB, the Bank has designated a member of senior management to serve as the Bank's Money Laundering Reporting Officer and appointed another senior officer as deputy to serve in his absence.

- The Audit Committee is comprised of three Directors and operates under the terms of reference set forth in a formal charter. By BMB policy, the Chairman of the Audit Committee must be an Independent Non-Executive Director. The Committee assists the Board through the review of the Bank's financial information, internal control systems, risk management process and internal audit function. The Audit Committee oversees the internal audit function and is charged with the evaluation of the Bank's external auditors. In addition, the Committee is charged with ensuring the Bank's compliance with applicable laws and regulations.

- The Bank's independent auditors, PricewaterhouseCoopers, have unhindered access to the Audit Committee, the Executive Committee and the Board of Directors, with or without members of management being present, to discuss their audit findings as to the integrity of the Bank's annual financial statements or reports, the adequacy of internal controls and any other matter which they believe should be brought to the attention of the Audit Committee, the Executive Committee and/or the Board of Directors.

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, private equity risk, interest rate risk, liquidity risk, operating risk and legal risk.

The Bank applies the following principles in its risk management discipline:
- an established risk governance structure
- defined risk limits and policies
- use of quantitative models and qualitative approaches to identify and assess risks
- ongoing review by an independent monitoring function
- portfolio diversification and the use of risk mitigation tools

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 2006, 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.

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 defining the overall credit risk management framework.

Credit risks is aggregated for a given economic entity (subsidiaries and affiliates) and are managed at that level. Credit standards are defined in the Bank's Credit Policies and Procedures Manual. Credit standards include a sound credit process addressing obligor, transaction and product risks, the quality of on-going performance, rating actions and concentration risk.

The Bank's risk grading system assigns a risk grade under a 10-grade scale, with 1 representing a risk which has the least chance of default. Risk grading is based on quantitative and qualitative risk characteristics and employs an objective measure in determining a risk grade for an exposure. Quantitative factors focus on historical and prospective financial strength such as cash flow, capital adequacy, profitability, asset quality and tenor of risk. Qualitative factors include management quality, market share, industry risk, sovereign risk and operating efficiency. All obligors and countries are risk graded. As part of the process, the Bank compares its internal ratings to publicly available ratings assigned by the major rating agencies.

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.

Credit risk can arise from several sources: loans, investments, and trading activities.

The Bank's other bonds portfolio is primarily secured by US Government securities and represents minimal risk.

Government Bonds comprise bonds received under the Central Bank of Iraq debt settlement program.

The instalment sale receivable is supported by an appropriate security package.

The Bank is not engaged in retail business and therefore does not use credit "scoring" models. Nor has the Bank securitized any assets. Accordingly, it has no recourse obligations under such transactions. As well, the Bank does not use credit derivatives as a risk mitigation tool. Nor does BMB have exposures to "highly leveraged institutions" as defined by the Financial Stability Task Force.

Additional information on credit risk can be found in the notes to our financial statements as follows:
- Aggregate credit exposures and significant components – Note 30
- Quantitative information by major business segments – Note 36
- Exposures by major types of counterparties – Notes 5, 6,7, 8, and 9
- Risk concentrations – Notes 5, 6, 7, 8, 9, 30, 31, 32, 33 and 34
- Non-performing loans, provisions, interest in suspense – Note 8

Market risk

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

It is the policy of the Bank to adhere to the quantitative and qualitative standards prescribed by the Basel Committee and the CBB for estimating market risks. The Bank uses the Standardised Approach to calculate capital adequacy requirements for regulatory compliance purposes.

The Bank uses the RiskMetrics™ model to measure market risks based on historical simulation approach under the RiskMetrics™ methodology. VaR is estimated for 99% one-tailed confidence level for a one-day holding period based on market price changes during the one-year historical observation period (the look back period). The VaR parameters correspond to the maximum potential loss in one out of 100 trading days. The market data such as correlation and volatility estimates are updated on a daily basis as provided by Datametrics™.

While the Bank had no trading activities during 2006, existing interest rate and foreign exchanges exposures (the latter resulting chiefly from foreign currency denominated private equity investments) and existing publicly-trade 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:

ILLUSTRATION 2
VaR by source of risk

Sources of Risk	2006 US$000	2005 US$000
Equity price risk	30	70
Interest rate risk	69	105
Foreign exchange rate risk	543	657
Less: Diversification benefit	(110)	(203)
Total VaR	532	629

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$ 609,840 (2005: US$ 644,000), US$ 480,278 (2005: US$ 495,000) and US$ 994,921 (2005: US$ 1,122,000) respectively, estimated for 99% confidence level for a one day holding period.

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

Interest rate risk

Interest rate risk is the risk arising from changes in interest rates, the slope and shape of yield curve and historical spreads between similar instruments (basis risk) which may have a potentially adverse impact on the net interest income of the Bank and on the value of trading positions and financial instrument portfolios.

Daily risk analysis reports from the market risk model assist management in measuring and monitoring the Bank's exposure to interest rate risk.

Note 32 provides data on the nature and extent of interest rate sensitive assets.

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.

Private equity investing is a key business for BMB.

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 2006, the Bank was effectively invested in over 1,340 companies (2005: 1,300) with an average investment size of US$ 62,000 (2005: US$ 78,000).

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.

Liquidity risk

Liquidity risk is twofold. First, it represents the risk that the Bank may not be able to secure funding in amounts sufficient to support its assets or that the interest rates and maturities it can obtain in the market are not appropriate for its assets. Such risk relates to securing funding for new assets as well as for any needed refinancing of existing assets. Second, it represents the risk that the Bank will be unable to sell assets in a timely fashion for prices close to their carrying values. BMB strives to minimise 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 three 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 impair liquidity. 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. The Bank also from time to time consults with leading financial intermediaries to assess its ability to securitize or otherwise dispose of its less liquid assets.

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 un-drawn commitments in its investment portfolio.

Note 33 reviews liquidity risk.

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.

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). The most significant operating risk involves payments.

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.

Note 29 discusses legal risk.

INCOME STATEMENT

OVERVIEW OF FINANCIAL RESULTS

The following points summarize BMB's 2006 financial performance:

- The net profit for the year was US$ 21.11 million compared to a profit of US$ 6.16 million in 2005.
- Net interest expense stood at US$ 5.36 million against US$ 5.93 million in 2005.
- Income from investments totalled US$ 27.19 million as compared to US$ 26.93 million in 2005.
- Gain from foreign exchange totalled US$ 6.06 million as compared to a loss of US$ 5.32 million in 2005.
- T&T Beverages Limited operations discontinued and put under voluntary liquidation in April 2006, resulting in savings in operating expenses of US$ 1.58 million.
- Other income totalled US$ 4.45 million as compared to US$ 2.54 million in 2005.
- Impairment provisions of US$ 0.48 million compared to US$ 3.27 million in 2005.

Net profit

The net profit for the year in 2006 amounted to US$ 21.11 million. The main contributors to this profit were: income from unquoted equity investments US$ 25.03 million (2005: US$ 22.00 million), unrealized foreign exchange income US$ 6.06 million (2005: loss US$ 5.32 million), other income US$4.45 million (2005: US$ 2.54 million) and substantial reduced effect of losses resulting from the consolidation of T&T Beverages Ltd of US$ 1.23 million (2005: loss US$ 2.81 million).

Income from investments

The income from investments amounted to US$ 27.19 million compared to US$ 26.93 million in 2005. The results of the Bank's various investment activities are summarized in the table below:

ILLUSTRATION 3
ANALYSIS OF INCOME FROM INVESTMENTS

Detail	2006 US$000	2005 US$000
Income from trading equities	2,069	2,067
(Loss)/ income from trading funds	(148)	71
Income from other equities and funds	25,027	22,000
Income from sovereign debt and bonds	173	110
Income from other bonds	73	2,682
Total income from investments	27,194	26,930

Foreign exchange translation

Foreign exchange translation gain was US$ 6.06 million compared to a loss of US$ 5.32 million in 2005. As the Bank's foreign exchange trading and swap lines were cancelled during 2002/2003, it was compelled to carry unhedged long sterling pound and euro currency positions. These positions are revalued against the Bank's US dollar functional currency on a daily basis and the resultant income or loss taken to the income statement. At 31 December 2006, the foreign exchange gains resulted from revaluation of these positions.

Other income

Other income which mainly comprises fees, commissions and rental income amounted to US$ 4.45 million compared to US$ 2.54 million in 2005, an increase of US$ 1.91 million. This is summarised in the following table:

ILLUSTRATION 4
ANALYSIS OF OTHER INCOME

Detail	2006 US$000	2005 US$000	Increase/ (decrease) US$000	Increase/ (decrease) %
Marketing related fees	3,233	1,899	1,334	70.2%
Rental income	875	823	52	6.3%
Other/(loss)	338	(180)	518	-
Total other income	4,446	2,542	1,904	74.9%

Operating expenses (general and administrative)

Operating expenses amounted to US$ 10.04 million for 2006 compared to US$ 8.78 million in 2005, an increase of US$ 1.26 million. This is summarised in the following table:

ILLUSTRATION 5
ANALYSIS OF OPERATING EXPENSES (General and Administrative)

Detail	2006 US$000	2005 US$000	(Increase)/ decrease US$000	(Increase)/ Decrease %
Staff costs	6,539	4,739	(1,800)	(38.0%)
Occupancy and equipment expense	988	900	(88)	(9.8%)
Other costs	2,511	3,140	629	20.0%
Total operating expenses	10,038	8,779	(1,259)	(14.3%)

Of the US$ 10.04 million (2005: US$ 8.78 million) in operating expenses, T&T's expenses were US$ 1.01 million (2005: US$ 2.55 million), which are included primarily in other costs.

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.

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 2006, a provision of US$ 0.48 million was made compared to US$ 3.27 million in 2005.

BALANCE SHEET

Total assets

Total assets at 31 December 2006 were US$ 172.67 million compared to US$ 168.41 million at 31 December 2005, an increase of US$ 4.26 million, or 2.5%.

This increase is mainly due to an increase in receivables from investment fund managers by US$ 14.20 million as partially offset by a decrease in other equities and funds by US$ 12.11 million. This change has resulted from the realizations of long term private equity investments and funds announced in the last quarter of 2006 where inflow of funds is expected in early 2007.

ILLUSTRATION 6
SUMMARY OF KEY BALANCE SHEET ITEMS

Detail	2006 US$000	2005 US$000
Trading equities and funds	8,506	7,234
Other equities and funds	75,690	87,804
Other bonds	9,687	9,809
Loans and advances	3,222	7,715
Medium Term Loan	43,700	53,200

Trading equities and funds

Trading equities and funds increased to US$ 8.50 million from US$ 7.23 million in 2005, an increase of US$ 1.27 million, or 17.5%. This was mainly due to additional investments made in equities, and increases in market values.

Other equities and funds

Other equities and funds (private equity) decreased to US$ 75.69 million from US$ 87.80 million in 2005, a decrease of US$ 12.11 million, or 13.8%. This decrease resulted mainly from realizations made during the year.

Undrawn other equity fund investment commitments increased to US$ 35.61million in 2006 from US$ 23.04 million in 2005, an increase of US$ 12.57 million, or 54.6% as the Bank made new commitments during the year. These unfunded investment commitments, which include customers' portions, will be funded over the course of the next six years.

Other bonds

The Bank's portfolio of other bonds decreased to US$ 9.69 million from US$ 9.81 million in 2005. This decrease resulted from receipts of partial repayments on student loan notes partially offset by an increase in amortized cost of CDO's.

An analysis of the other bonds portfolio is given below:

Summary of portfolio of other bonds

Other bonds comprise:	Student Loans		CDOs		Total	
	2006 US$000	2005 US$000	2006 US$000	2005 US$000	2006 US$000	2005 US$000
Held-to-maturity – at amortised cost						
Structured products	-	-	4,113	3,945	4.113	3,945
Loans and receivables – at amortised cost						
Structured products	574	864	5,000	5,000	5,574	5,864
Total other bonds	574	864	9,113	8,945	9,687	9,809

Loans and advances

Loans and advances at 31 December 2006 decreased to US$ 3.22 million from US$ 7.71 million in 2005, a decrease of US$ 4.49 million, or 58.2%. This decrease was mainly due to a specific government exposure being repaid in the form of a Government Bond.

Medium Term Loan

The medium term loan decreased by US$9.5 million as the first instalment due in June 2006, as part of the refinancing agreement, was paid.

Revolving loan facility

Detail	2006 US$000	2005 US$000
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 2006 was US$ 13.6 million (31 December 2005: US$ 13.6 million). By an amended agreement signed in December 2006, the facility has been extended to 30 December 2007, and bears interest at floating Libor plus 25 basis points.

Liquidity

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

ILLUSTRATION 7
SUMMARY OF NET LIQUID POSITION

Detail	2006 US$000	2005 US$000
Inter-bank placements and cash	12,708	13,263
Trading equities and funds	8,506	7,234
Other liquid bonds	5,000	5,000
Total liquid assets	26,214	25,497
Customer deposits maturing within 12 months	(31,329)	(33,954)
Medium term loan/due within 12 months	(15,200)	(9,500)
Repos on Other bonds	(3,700)	(3,700)
Revolving loan facility	(13,600)	(13,600)
Total liquid liabilities	(63,829)	(60,754)
Net liquid position	(37,615)	(35,257)

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 2006, the total capital ratio using the standardised approach was 20.22% compared to 13.25% at 31 December 2005.

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 8
CAPITAL BASE AND RISK WEIGHTED ASSETS

	Average for the year 2006 US$000	At year-end 2006 US$000	Average for the year 2005 US$000	At year-end 2005 US$000
Capital base				
Tier 1 capital	22,643	35,748	(11,017)	15,258
Tier 2 capital	16,552	14,668	-	15,258
Total Capital base	39,195	50,416	(11,017)	30,516
Risk weighted assets				
Credit risk weighted assets	166,782	171,485	165,696	157,634
Market risk weighted assets	79,573	77,838	74,435	72,610
Total risk weighted assets	246,355	249,323	240,131	230,244
Capital ratio (standardized approach)	15.91%	20.22%	(4.59%)	13.25%
Minimum required	12.00%	12.00%	12.00%	12.00%

Earnings per share and price/earning ratio

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

ILLUSTRATION 9
REVIEW OF EARNINGS PER SHARE AND PRICE EARNINGS RATIO

Detail	2006	2005
Net profit	US$ 21,115,000	US$ 6,165,000
Number of shares (fully diluted)	209,351,949	262,512,073
Earnings per share	US$ 0.10	US$ 0.02
BMB's year-end share price on the Bahrain Stock Exchange	US$ 0.26	US$ 0.26
Book value per share	US$ 0.22	US$ 0.10
Price/ earnings ratio	2.60	13.00

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 10
DIRECTORS AND SENIOR MANAGEMENT SHAREHOLDINGS

Detail	2006 Number	2005 Number
Directors and their related parties	136,349,632	136,101,632
Senior management	95,003	95,003
Total	136,444,635	136,196,635

ILLUSTRATION 11
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 2006 were as follows:

	Banking		Manufacturing		Consolidated	
	2006	2005	2006	2005	2006	2005
	US$000	US$000	US$000	US$000	US$000	US$000
Net interest (expense)/ income	(5,360)	(4,232)	1	(1,699)	(5,359)	(5,931)
Income from investments	27,194	26,930	-	-	27,194	26,930
Foreign exchange translation income/(loss) *	6,062	(8,794)	-	-	6,062	(5,325)
Other income/(loss)	4,660	2,792	(214)	(250)	4,446	2,542
Total income/(loss) from operations	32,556	16,696	(213)	(1,949)	32,343	18,216
Impairment provisions	(480)	(3,255)	-	(17)	(480)	(3,272)
General and administrative expenses	(9,024)	(6,234)	(1,014)	(2,545)	(10,038)	(8,779)
Total operating expenses	(9,504)	(9,489)	(1,014)	(2,562)	(10,518)	(12,051)
Net income before taxation	23,052	7,207	(1,227)	(4,511)	21,825	6,165
Taxation	(710)	-	-	-	(710)	-
Net income/(loss) for the year	22,342	7,207	(1,227)	(4,511)	21,115	6,165

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.

* In 2005, the foreign exchange translation loss of US$ 8.79 million included a loss of US$ 3.47 million incurred from the long sterling position held for loans made to T&T. The loss was eliminated on consolidation as the related sterling position was off-set on consolidation. As T&T has been placed under liquidation in 2006, the foreign currency position in respect of loans was written off, hence, the long sterling position no longer remained at 31 December 2006. Therefore, the translation gain for 2006, US$ 6.06 million, is not affected by the consolidation of T&T at 31 December 2006.

AUDITORS’ REPORT TO THE SHAREHOLDERS OF

BAHRAIN MIDDLE EAST BANK (B.S.C.)

Report on the 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 of 31 December 2006 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 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the 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 financial statements.

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

AUDITORS' 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 of 31 December 2006, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to Note 29(b) to the consolidated financial statements. The Bank is the defendant in a lawsuit alleging non-compliance of a legal procedural requirement with regards to the Bank's holding of the Extra Ordinary General Meeting of 11 May 2005 which considered the reorganisation and capital raising of the Bank's issued and paid up capital. The first degree Court and the Court of Appeals ruled in favour of the plaintiff. The Bank has filed a final objection and appeal before the Court of Cassation. The ultimate outcome of this matter and its impact on the consolidated financial statements cannot presently be determined.

Report on other legal and regulatory requirements

Further, as required by the Bahrain Commercial Companies Law ("BCCL") and the Central Bank of Bahrain Law ("CBBL"), 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 account and the consolidated financial statements and the financial information contained in the Directors' 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 BCCL, the CBBL, 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 2006.

PricewaterhouseCoopers

3 February 2007
Manama, Kingdom of Bahrain

CONSOLIDATED BALANCE SHEET
AT 31 DECEMBER 2006
(Expressed in thousands of United States Dollars)

	2006	Restated 2005
ASSETS		
Cash and deposits with banks (Note 3)	12,708	13,263
Trading equities and funds (Note 4)	8,506	7,234
Government bonds (Note 5)	4,388	-
Other equities and funds (Note 6)	75,690	87,804
Other bonds (Note 7)	9,687	9,809
Loans and advances (Note 8)	3,222	7,715
Instalment sale receivable (Note 9)	20,311	21,869
Fixed assets (Note 10)	12,796	11,136
Other assets (Note 11)	25,358	9,581
TOTAL ASSETS	172,666	168,411
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Customer deposits (Note 12)	47,595	54,158
Securities sold under repurchase agreements (Note 13)	3,700	3,700
Medium term loan (Note 14)	43,700	53,200
Revolving loan facility (Note 15)	13,600	13,600
Other liabilities (Note 16)	7,644	6,505
Subordinated loans (Note 17)	10,000	10,000
TOTAL LIABILITIES	126,239	141,163
Shareholders' equity		
Share capital (Note 18)	52,338	52,338
Fair value reserve (Note 19)	3,580	6,933
Fixed asset revaluation reserve (Note 19)	7,098	5,056
Other reserves (Note 19)	(16,589)	(37,079)
TOTAL SHAREHOLDERS' EQUITY	46,427	27,248
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	172,666	168,411

These financial statements were approved by the Board of Directors on 3 February 2007 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 38 form an integral part of these financial statements.

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006
(Expressed in thousands of United States Dollars unless otherwise stated)

	2006	Restated 2005
Interest income	2,016	2,109
Interest expense	(7,375)	(8,040)
NET INTEREST (EXPENSE)	(5,359)	(5,931)
Income from investments (Note 20)	27,194	26,930
Foreign exchange translation income/(loss) (Note 21)	6,062	(5,325)
Other income (Note 22)	4,446	2,542
TOTAL INCOME FROM OPERATIONS	32,343	18,216
Impairment provisions (Note 23)	(480)	(3,272)
General and administrative expenses (Note 24)	(10,038)	(8,779)
TOTAL OPERATING EXPENSES	(10,518)	(12,051)
NET INCOME BEFORE TAXATION	21,825	6,165
TAXATION	(710)	-
NET INCOME FOR THE YEAR	21,115	6,165
EARNINGS PER SHARE (Note 18)		
Basic	US$ 0.10	US$ 0.02
Diluted	US$ 0.10	US$ 0.02

These financial statements were approved by the Board of Directors on 3 February 2007 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 38 form an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2006
(Expressed in thousands of United States Dollars)

				Other reserves					
	Share capital	Fixed asset revaluation reserve	Fair value reserve	Retained earnings	Legal reserve	General reserve	Total other reserves	Treasury shares	Total
At 1 January 2005	90,809	5,056	(12,973)	(104,639)	10,960	9,361	(84,318)	(26,351)	(27,777)
Prior year adjustment (note 37)	-	-	24,061	(24,061)	-	-	(24,061)	-	-
Adjusted balance – 1 January 2005	90,809	5,056	11,088	(128,700)	10,960	9,361	(108,379)	(26,351)	(27,777)
Exchange translation adjustment	-	-	(379)	899	-	-	899	-	520
Net fair value gain on available-for-sale investments	-	-	7,495	-	-	-	-	-	7,495
Fair value reserve transferred to income statement	-	-	(11,271)	-	-	-	-	-	(11,271)
Increase in capital (note 18)	52,335	-	-	-	-	-	-	-	52,335
Reduction in capital (note 18)	(90,806)	-	-	64,455	-	-	64,455	26,351	-
Rights issue expense	-	-	-	(219)	-	-	(219)	-	(219)
Net profit for the year	-	-	-	6,165	-	-	6,165	-	6,165
Transfer to reserves (note 19)	-	-	-	(1,554)	777	777	-	-	-
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 10 and 19)	-	2,042	-	-	-	-	-	-	2,042
Net fair value gain on available-for-sale investments	-	-	8,966	-	-	-	-	-	8,966
Fair value reserve transferred to income statement	-	-	(13,296)	-	-	-	-	-	(13,296)
Net profit for the year	-	-	-	21,115	-	-	21,115	-	21,115
Transfer to reserves (note 19)	-	-	-	(2,111)	2,111	-	-	-	-
At 31 December 2006	52,338	7,098	3,580	(40,575)	13,848	10,138	(16,589)	-	46,427

Notes 1 to 38 form an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CASHFLOWS
FOR THE YEAR ENDED 31 DECEMBER 2006
(Expressed in thousands of United States Dollars)

	2006	Restated 2005
CASHFLOWS FROM OPERATING ACTIVITIES		
NET INCOME FOR THE YEAR	21,115	6,165
Adjustments to reconcile net profit to net cash provided by operating activities:		
Impairment provisions (Note 23)	615	3,272
Depreciation and amortisation	450	(583)
Profit on sale of fixed assets	(3)	-
Net changes in:		
Trading equities and funds	(1,272)	(2,612)
Government bonds	(4,388)	-
Other equities and funds	8,146	6,853
Other bonds	122	13,212
Loans and advances	4,493	195
Accrued interest receivable	(254)	2,130
Accrued interest payable	147	(1,063)
Other assets	(15,523)	(4,518)
Other liabilities	1,000	(620)
Customer deposits	(6,563)	(15,876)
Change in exchange rates related to retained earnings of overseas subsidiaries	(625)	899
Foreign exchange movements on investments and others	(116)	115
NET CASH PROVIDED BY OPERATING ACTIVITIES	7,344	7,569
CASH FLOWS FROM INVESTING ACTIVITIES		
Amount received against instalment sale receivable	1,558	616
Purchase of fixed assets (Note 10)	(63)	(129)
Proceeds from sale of fixed assets	10	-
NET CASH PROVIDED BY INVESTING ACTIVITIES	1,505	487

Notes 1 to 38 form an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CASHFLOWS (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2006
(Expressed in thousands of United States Dollars)

	2006	Restated 2005
CASH FLOWS FROM FINANCING ACTIVITIES		
Net changes in:		
Medium term loan	(9,500)	(5,000)
Securities sold under repurchase agreements	-	(5,000)
Prior year dividends claimed and paid	(20)	(67)
Share capital (Note 18)	-	12,193
NET CASH (USED IN)/PROVIDED BY FINANCING ACTIVITIES	(9,520)	2,126
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	116	(115)
Net (decrease)/increase in cash and cash equivalents	(555)	10,067
Cash and cash equivalents at the beginning of the year	13,263	3,196
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR (NOTE 3)	12,708	13,263

Notes 1 to 38 form an integral part of these financial statements.

1 INCORPORATION AND PRINCIPAL ACTIVITY

Bahrain Middle East Bank (E.C.) (the “Bank" or "BMB") was formed in the Kingdom of Bahrain as an exempt joint stock company, pursuant to the notarisation of its Memorandum and Articles of Association on 21 March 1982. Formalities in respect of the registration of the Bank were completed on 5 July 1982, the Bank's date of incorporation. Effective 10 April 2000, the Bank launched a new brand identity and is now known as BMB Investment Bank. The legal name of the Bank continues to be Bahrain Middle East Bank (B.S.C.) which has its registered office at BMB Centre, Diplomatic Area, Manama, Bahrain.

On 30 August 2005, the Bank formally amended its Memorandum and Articles of Association to comply with provisions of the Bahrain Commercial Companies Law of 2001 of the Kingdom of Bahrain and the Implementing Regulations issued by Ministerial Resolution No. 6 for 2002. As part of this process, the Bank converted from an Exempt Company to a Shareholding Company and the legal duration of the Bank was amended from a twenty-five year period to an indefinite period.

The Group comprises the Bank and its subsidiaries.

The principal activities of the Group are the provision of investment banking, private banking and treasury services.

2 SIGNIFICANT ACCOUNTING POLICIES

Preparation of financial statements

The Group’s consolidated financial statements are prepared in accordance with and comply with International Financial Reporting Standards as promulgated by the International Accounting Standards Board (“IASB”). The consolidated financial statements are 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 statements have been prepared in United States Dollars.

Critical accounting estimates and judgements in applying accounting policies

IAS 1 (revised) requires the disclosures of judgements, apart from those involving estimations, which management has made in the process of applying the Group’s accounting policies that have the most significant effect on the amounts recognised in the financial statements. 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.

Basis of consolidation

The consolidated financial statements include the assets, liabilities and results of the operations of the Group. Subsidiary companies, 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. These companies are accounted for and disclosed as available-for-sale assets and are included in other equities and funds.

All intra-group balances and transactions have been eliminated.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 statement 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 (which includes transaction costs) and subsequently re-measured at fair value. All related realised and unrealised gains and losses are included in net trading income.

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 cashflows 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.

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

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 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 cashflow 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.

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.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Interest on Government and Government Agency bonds is accrued based on the effective interest rate method.

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.

Interest income on other bonds is accrued based on the effective interest rate method.

Loans and advances

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

Interest income is accrued based on contractual interest rates. Fees and commissions received are amortised over the period of the loan.

Instalment sale receivable

The instalment sale receivable is carried at amortised cost. The interest income on the instalment sale receivable is recognised on an accruals basis using the effective interest rate method.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 lives as follows:

Buildings	25 years
Other fixed assets	2-8 years

Effective 30 September 2004, the Bank adopted a new policy to revalue its freehold land and buildings 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 is 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 for restructuring expenses

Provision for restructuring expenses is recognised when the Board of Directors has approved a restructuring and the Bank can reliably estimate the amount of currently existing obligations related to the restructuring.

Dividends

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

Directors' remuneration

Directors' remuneration is recognised as a liability when approved.

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

Fees and commissions 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.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

Segmental 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.

3 CASH AND DEPOSITS WITH BANKS

Cash and deposits with banks comprise:

	2006 US$000	2005 US$000
Placements with banks	10,493	12,114
Money at call	2,149	1,083
Balances with Central Bank	66	66
Total cash and deposits with banks	12,708	13,263

4 TRADING EQUITIES AND FUNDS

Trading equities and funds comprise:

	2006 US$000	2005 US$000
Quoted equities	8,506	6,435
Managed funds	-	799
Total trading equities and funds	8,506	7,234

5 GOVERNMENT BONDS

Government bonds comprise:

	2006 US$000	2005 US$000
Held-to-maturity		
Government bonds	4,388	-
Total Government bonds	4,388	-

6 OTHER EQUITIES AND FUNDS

Other equities and funds comprise:

	2006 US$000	2005 US$000
Available-for-sale		
Unquoted equity fund investments - at fair value	62,225	78,622
Unquoted equity investments - at fair value	12,297	5,968
Unquoted equity investments - at cost	1,168	3,214
Total other equities and funds	75,690	87,804

The fair values in respect of unquoted equity investments carried at an amount of US$ 1,168,000 (2005: US$ 3,214,000) could not be reliably determined. These unquoted equity investments are measured at cost less provisions for impairment.

At 31 December 2006, the Bank had undrawn investment commitments to private equity funds of US$ 35,611,000 (31 December 2005: US$ 23,037,000) (note 28). 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.

6 OTHER EQUITIES AND FUNDS (CONTINUED)

As disclosed in note 15, certain of the Bank's private equity investments are pledged against the revolving loan facility.

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

	Unquoted equity investments - at cost 2006 US$000	Unquoted equity fund investments - at fair value 2006 US$000	Total 2006 US$000	Unquoted equity investments - at cost 2005 US$000	Unquoted equity fund investments - at fair value 2005 US$000	Total 2005 US$000
At 1 January	1,472	-	1,472	1,614	-	1,614
Charge for the year (note 23)	-	615	615	-	1,603	1,603
Amounts written off	-	(615)	(615)	-	(1,603)	(1,603)
Foreign exchange movements	90	-	90	(142)	-	(142)
At 31 December	1,562	-	1,562	1,472	-	1,472

7 OTHER BONDS

Other bonds comprise:	2006 US$000	2005 US$000
Held-to-maturity – at amortised cost		
Structured products	4,113	3,945
Loans and receivables – at amortised cost		
Structured products	5,574	5,864
Total other bonds	9,687	9,809

Other bonds classified as held-to-maturity and loans and receivables had a fair value of US$ 4,094,500 and US$ 4,699,000 respectively (31 December 2005: US$3,895,000 and US$ 4,759,000 respectively).

During 2005, certain assets serving as collateral for the Bank's investment in Other Bonds were redeemed, resulting in a US$ 12,380,000 reduction in the portfolio. Of the remaining bonds held, US$ 10,000,000 (2005: US$10,000,000) are secured by US Government zero coupon bonds.

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

In the normal course of banking business, certain bonds are pledged to parties under Repo agreements (note 13).

Other bonds are stated after deducting impairment provisions as follows:

	2006 US$000	2005 US$000
At 1 January	11,834	24,663
Amounts recovered	-	(12,962)
Charge for the year (note 23)	-	133
At 31 December	11,834	11,834

8 LOANS AND ADVANCES

(a) Composition

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

	Commercial		Government		Total	
	2006 US$000	2005 US$000	2006 US$000	2005 US$000	2006 US$000	2005 US$000
Americas	-	-	669	609	669	609
Rest of the world	2,452	55	101	7,051	2,553	7,106
Total loans and advances	2,452	55	770	7,660	3,222	7,715

8 LOANS AND ADVANCES (CONTINUED)

Commercial loans are stated at cost less impairment provisions. Government loans include US$ 770,000 (31 December 2005: US$ 685,000) which are held for trading and carried at market value.

(b) Provisions for impairment on loans and advances

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

	Specific	
	2006	2005
	US$000	US$000
At 1 January	25,303	31,417
Amounts written off	(25,168)	(3,000)
Amount (released)/charged for the year (note 23)	(135)	1,519
Foreign exchange movement	-	(4,633)
At 31 December	-	25,303

The foreign exchange movement relates to the year-end revaluation of provisions against foreign currency denominated loans and is matched by a corresponding movement in the carrying amounts of such loans and advances.

(c) Non-accrual loans

	Over 3 years	
	2006	2005
	US$000	US$000
Government		
Americas	669	609
Rest of the world	101	7,051
Total non-accrual loans	770	7,660

(d) Unrecognized contractual interest

	2006	2005
	US$000	US$000
At 1 January	15,509	18,529
Amounts written off	(12,570)	(1,390)
Amounts unrecognized within the year	395	458
Foreign exchange movement	116	(2,088)
At 31 December	3,450	15,509

9 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 the US$ 20,000,000 subordinated debt agreement dated 20 June 2001 (note 17).

9 **INSTALMENT SALE RECEIVABLE (CONTINUED)**

In connection with its rights offering and private placement (note 18), the US $20,000,000 subordinated loan which provided credit support to the instalment sale receivable, was converted to equity. The Bank has obtained appropriate replacement collateral to secure this receivable (note 26).

10 **FIXED ASSETS**

Fixed assets comprise:

2006	Freehold land and building US$000	Other fixed assets US$000	Total US$000
At 1 January 2006			
Cost/valuation	11,400	6,764	18,164
Accumulated depreciation	(475)	(6,553)	(7,028)
Net book amount	10,925	211	11,136
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	(389)	(61)	(450)
Closing net book amount	12,599	197	12,796
At 31 December 2006			
Cost/valuation	12,599	6,664	19,263
Accumulated depreciation	-	(6,467)	(6,467)
Net book amount	12,599	197	12,796

2005	Freehold land and building US$000	Other fixed assets US$000	Total US$000
Cost/Valuation			
At 1 January	11,406	6,739	18,145
Additions	5	124	129
Disposals	(11)	(67)	(78)
Exchange rate adjustments	-	(32)	(32)
At 31 December	11,400	6,764	18,164
Accumulated depreciation			
At 1 January	97	6,537	6,634
Charge for the year	389	104	493
Disposals	(11)	(67)	(78)
Exchange rate adjustments	-	(21)	(21)
At 31 December	475	6,553	7,028
At 31 December 2005			
Cost/valuation	11,400	6,764	18,164
Accumulated depreciation	(475)	(6,553)	(7,028)
Net book amount	10,925	211	11,136

The land and building was revalued in December 2006 at US$ 12,600,000 (note 19). The land and building are mortgaged in favour of the Bank's lenders (note 14).

11 OTHER ASSETS

Other assets comprise:

	2006 US$000	2005 US$000
Accrued interest receivable	669	415
Management fees receivable	256	200
Receivable from investment fund managers	20,126	5,926
Prepayments	630	668
Other	3,677	2,372
Total other assets	25,358	9,581

12 CUSTOMER DEPOSITS

Customer deposits comprise:

	2006 US$000	2005 US$000
Customer participation in funds	23,847	23,660
Government entities, corporates and individuals	23,748	30,498
Total customer deposits	47,595	54,158

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$ 9,511,000 (31 December 2005: US$ 14,502,000) in deposits held on behalf of BMB Technology and Telecommunications Fund (note 28).

13 SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

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

	2006 US$000	2005 US$000
Repos on other bonds (note 7)	3,700	3,700
Total securities sold under repurchase agreements	3,700	3,700

14 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, were 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. Among these conditions were the following: (a) the raising of at least US $43,500,000 in new equity, (b) a US$ 5,000,000 principal downpayment, (c) a mortgage in favour of the lenders on the Bank's head office land and building (note 10), (d) establishment of a pledged account in connection with mechanism under which 50% of the Bank's excess operating cashflow over a minimum cash balance threshold would be dedicated to debt service, and (e) extension of the maturity of the US $10,000,000 subordinated loan (note 17) to December 2008.

14 MEDIUM TERM LOAN (CONTINUED)

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 (note 18), 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 $28,500,000 (June 2008). The instalment of US$ 9,500,000 due in June 2006 has been paid. A refinancing fee of 1% was paid and is being amortized over the life of the loan to maturity.

15 REVOLVING LOAN FACILITY

	2006 US$000	2005 US$000
Revolving loan facility	13,600	13,600

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 has been extended to 30 December 2007 with a revised interest rate of floating US$ Libor plus 25 basis points.

16 OTHER LIABILITIES

Other liabilities comprise:

	2006 US$000	2005 US$000
Accrued interest payable	763	616
Unclaimed dividends	3,405	3,425
Employee leaving indemnity (note 25)	1,074	906
Accrued expenses	1,708	728
Other	694	830
Total other liabilities	7,644	6,505

17 SUBORDINATED LOANS

On 20 June 2001, the Bank raised a subordinated debt facility of US$ 20,000,000 repayable in 2015. 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. As part of an arrangement for refinancing of its US$ 75,000,000 medium term facility, and for the rights issue made in June 2005, the subordinated debt was fully converted to equity (notes 9, 14 and 18).

On 29 June 2001, the Bank raised a separate subordinated debt facility of US$ 10,000,000 repayable on 29 December 2006 which was extended to December 2008 as a condition for the refinancing of the US$ 75,000,000 medium term facility (notes 9, 14 and 18). 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 20).

On 1 November 2001, the interest payable on both the above subordinated facilities 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 20).

18 SHARE CAPITAL

Share capital comprises:

	2006		2005	
	Number 000	Amount US$000	Number 000	Amount US$000
Authorised				
Ordinary shares of US$0.25 each	2,000,000	500,000	2,000,000	500,000
Issued and fully paid				
Ordinary shares of US$0.25 each				
At 1 January	209,352	52,338	363,238	90,809
Reduction in capital	-	-	(363,225)	(90,806)
New shares issued	-	-	209,339	52,335
At 31 December	209,352	52,338	209,352	52,338
Treasury shares	-	-	-	-

Trading of the Bank's shares on the Bahrain Stock Exchange, which was suspended in June 2004, pursuant to a request by the Bank made pending the finalisation of the refinancing of its US$ 75,000,000 medium term facility and the completion of the rights issue, resumed on 4 September 2005.

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

	2006			2005		
Ordinary shares	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	13,139	3.40%	7,053,068	13,141	3.37%
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	28.47%	59,683,345	4	28.50%
10% up to less than 20%	-	-	-	-	-	-
20% up to less than 50%	135,148,865	2	64.56%	135,148,865	2	64.56%
50% and above	-	-	-	-	-	-
	209,351,950	13,146	100%	209,351,950	13,148	100%

Treasury shares

At 31 December 2006, the Bank owned 1 of its own shares (31 December 2005: 1share). This share is treated as a deduction from the shareholders' equity.

Capital restoration

Rights issue and private placement

The shareholders of the Bank, at their Extraordinary General Meeting held on 11 May 2005 approved a capital reorganization and capital raising plan.

The capital raising took place during the month of July 2005 and was composed of a Rights Offering of US$ 50,000,000 and a Private placement and Debt/Deposit Conversion to Equity Program of US$50,000,000.

18 SHARE CAPITAL (CONTINUED)

An aggregate of US$ 52,300,000 was raised under both programs.

On 30 August 2005, the Bank implemented the capital reorganization and capital raising programs by formally registering the following changes in its capital with the relevant authorities in the Kingdom of Bahrain.

1. Reduction in capital in paid-in-capital to US$ 3,281.75 (13,127 shares of stock at par value of US$ 0.25 each) via the capitalization of US$ 90,806,145 of accumulated losses and treasury shares against the issued and paid in share capital of US$ 90,809,426.75.

2. A simultaneous increase in paid-in-capital by US$ 52,334,705.75 (209,338,823 shares of stock at par value of US$ 0.25 each) representing proceeds of US$ 35,434,701.75 (141,738,807 shares of stock at par value of US$ 0.25 each) raised in the Rights Offering and US$ 16,900,004 (67.600.016 shares of stock at par value of US$ 0.25) raised in the Private Placement and Debt/Deposit Conversion to Equity Program.

As a result, the issued and paid-in-capital of the Bank is US$ 52,337,987.50 consisting of 209,351,950 shares of common stock with a par value of US$ 0.25 each. The Bank's Memorandum and Articles of Association was amended to reflect this change.

The capital raising exercise resulted in:

1. The conversion of the US$ 20,000,000 subordinated loan to equity (note 17).

2. The conversion of US$ 16,800,000 of the Medium Term Loan to equity (note 14).

3. The conversion of US$ 100,000 in deposits to equity.

4. Proceeds of US$ 15,400,000 subscription fromshareholders, of which US$ 13,800,000 was from the Bank's major shareholder.

The validity of the Extraordinary General Meeting in which the capital raising was approved has been challenged by a shareholder in a court of law (note 29).

Earnings per share

Earnings per share is computed as below:

	Basic		Diluted	
	2006	2005	2006	2005
Net income	US$ 21,115,000	US$ 6,165,000	US$ 21,115,000	US$ 6,165,000
Weighted average number of shares	209,351,949	262,512,073	209,351,949	262,512,073
Earning per share	US$ 0.10	US$ 0.02	US$ 0.10	US$ 0.02

19 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 by 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.

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 buildings once in 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, has been credited to the fixed asset revaluation reserve. The building is now being depreciated over its estimated useful life of 20 years from 1 January 2007.

20 INCOME FROM INVESTMENTS

Income from investments comprises:

	2006 US$000	2005 US$000
(Loss)/Income from managed funds – trading	(148)	71
Income from quoted equities – trading	1,704	1,853
Income from sovereign debt and bonds – trading	173	110
Income from other equities and funds	24,908	21,824
Income from other bonds	73	2,682
Dividend income	484	390
Total income from investments	27,194	26,930

21 FOREIGN EXCHANGE TRANSLATION INCOME

Foreign exchange translation income/(loss) comprises:

	2006 US$000	2005 US$000
Foreign exchange translation income/(loss)	6,062	(5,325)
Total foreign exchange translation income/(loss)	6,062	(5,325)

The foreign exchange income/(loss) results from the translation of positions primarily held in foreign currencies in investments and loans.

22 OTHER INCOME

Other income comprises:

	2006 US$000	2005 US$000
Fees and commissions	3,233	1,899
Rental income	875	823
Other /(loss)	338	(180)
Total other income	4,446	2,542

23 IMPAIRMENT PROVISIONS

The specific provision charge comprises:

	2006 US$000	2005 US$000
Charge for other equities and funds (note 6 and 37)	615	1,603
Write off for other assets	-	17
(Release)/charge for loans and advances (note 8)	(135)	1,519
Net charge for other bonds (note7)	-	133
Total charge for impairment provisions	480	3,272

24 GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses comprise:

	2006 US$000	2005 US$000
Salaries and other personnel expenses (note 25)	6,539	4,739
Occupancy and equipment	988	900
Other	2,511	3,140
Total general and administrative expenses	10,038	8,779

25 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$ 67,000 (31 December 2005: US$ 68,000). 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:

	2006 US$000	2005 US$000
At 1 January	906	647
Accruals for the year	229	259
Paid during the year	(61)	-
At 31 December (note 16)	1,074	906

	2006 Number	2005 Number
Employees at 31 December	66	67

26 RELATED-PARTY TRANSACTIONS

	Directors and key management personnel 2006 US$000	Directors and key management personnel 2005 US$000
Loans		
At 1 January	624	555
Advanced during the year	141	104
Repayments during the year	(80)	(35)
At 31 December	685	624
Administration charges for the year	7	7

No loans were advanced to any director of the Bank during the year or in 2005.

No provisions have been recognised in respect of loans given to related parties (31 December 2005: Nil).

The above loans are included as part of Other assets.

26 RELATED-PARTY TRANSACTIONS (CONTINUED)

The loans made to key management personnel are repayable monthly up to a period of three years except for the loan to the Chief Executive which does not have a set repayment schedule. All loans are fully secured and bear an administration charge of 1% per annum (2005: 1% p.a.).

	Directors and key management personnel 2006 US$000	Directors and key management personnel 2005 US$000
Deposits		
At 1 January	95	3,363
Received during the year	340	11,580
Repaid during the year	(381)	(14,989)
Interest capitalised during the year	3	141
At 31 December	57	95
Interest expense on deposits for the year	3	141

Key management compensation

Compensation to key management personnel including directors were as follows:

	2006 US$ 000	2005 US$ 000
Salaries and other short-term employee benefits	2,254	1,350
Termination benefits	109	100
	2,363	1,450
Directors' remuneration	347	31

Directors' remuneration includes US$300,000 as proposed payment to be approved by the OGM.

Guarantee

The Bank has received a corporate payment guarantee from Al Fawares with regard to the Instalment Sale Receivable (note 9).

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.

27 INVESTMENTS IN SUBSIDIARIES

Listing of subsidiaries

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

Subsidiaries	Ownership interest 2006	Ownership interest 2005	Country of Incorporation	Nature of business
BMB Investment Company (Jersey) Limited	100%	100%	Jersey	Investment holding
Adhari Limited	100%	100%	Cayman Islands	Investment holding
T&T Beverages Limited (T&T)	93.9%	93.9%	United Kingdom	Softdrinks

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

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

28 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:

	2006 US$000	2005 US$000
Undrawn investment commitments in other equities and funds (note 6)	35,611	23,037
Funds under management	41,981	43,107
Discretionary accounts	78,524	69,627
Non-cancellable operating lease	-	50

Undrawn investment commitments in other equities and funds include US$ 9,618,000 (31 December 2005: US$ 5,020,000), 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 2006. Discretionary accounts include funds managed on behalf of customers pertaining to sub-participation in other private equity funds, unquoted equities and other debt instruments.

29 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 has come to a final conclusion in the Bank’s favour.

On 10 August 2003, the Kuwaiti litigant filed a suit in Bahrain. The case is pending in the courts of Bahrain having been adjourned several times, the latest being 15 January 2007. The case was postponed again to a date to be determined by the Court. 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.

29 LEGAL CLAIMS (CONTINUED)

BMB has filed an appeal with the Court of Cassation and remains confident that it will prevail. In the event that the Bank loses the appeal it will regularize the decisions taken at the EGM and related matters by holding another EGM.

30 CREDIT RISK AND CONCENTRATIONS OF CREDIT RISK

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Group attempts to control credit risk both on and off-balance sheet by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties. The Group's risk grading system assigns a risk grade under a ten grade scale, with one being the highest grade having least chances of default. The risk grading is based on quantitative and qualitative risk characteristics and employs an objective measure in determining a risk grade for an exposure. Quantitative factors focus on the historical and prospective financial strengths such as cash flow, capital adequacy, profitability, asset quality, tenor of risk and qualitative factors include management quality, market share, industry risk, sovereign risk and operating efficiency. All obligors and countries are risk graded.

In addition to monitoring credit limits, the Group manages the credit exposure relating to its trading activities by entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposures.

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location.

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

The Group controls the credit risk arising from derivative and foreign exchange contracts through its credit approval process and the use of risk control limits and monitoring procedures. The Group uses the same credit procedures when entering into derivative and foreign exchange transactions as it does for traditional lending products.

Overall, Bank management believes that its policies and procedures for managing credit risk in the activities that it undertakes represent a reasonable and prudent approach.

30 CREDIT RISK AND CONCENTRATIONS OF CREDIT RISK (CONTINUED)

The Group's assets, liabilities, off-balance sheet items are summarised by geographical area as follows:

	North America		Europe		Rest of the world		Total	
	2006	2005	2006	2005	2006	2005	2006	2005
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Assets								
Cash and deposits with banks	1,229	24	11,308	13,020	171	219	12,708	13,263
Trading equities and funds	4	612	6,556	4,356	1,946	2,266	8,506	7,234
Government Bonds	-	-	-	-	4,388	-	4,388	-
Other equities and funds	39,079	42,843	29,659	38,004	6,952	6,957	75,690	87,804
Other bonds	9,113	8,945	574	864	-	-	9,687	9,809
Loans and advances	669	609	-	-	2,553	7,106	3,222	7,715
Instalment sale receivable	-	-	-	-	20,311	21,869	20,311	21,869
	50,094	53,033	48,097	56,244	36,321	38,417	134,512	147,694
Other assets							38,154	20,717
Total assets							172,666	168,411
Liabilities								
Customer deposits	14	-	306	423	47,275	53,735	47,595	54,158
Securities sold under repurchase agreements	-	-	-	-	3,700	3,700	3,700	3,700
Medium term loan	-	-	11,500	14,000	32,200	39,200	43,700	53,200
Revolving loan facility	-	-	-	-	13,600	13,600	13,600	13,600
Subordinated loans	-	-	-	-	10,000	10,000	10,000	10,000
	14	-	11,806	14,423	106,775	120,235	118,595	134,658
Other liabilities							7,644	6,505
Shareholders' equity							46,427	27,248
Total liabilities and shareholders' equity							172,666	168,411
Off-balance sheet credit and investment instruments	5,335	5,927	30,276	17,160	-	-	35,611	23,087

31 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.

	Net on-balance sheet position		Off balance sheet commitments	
	2006	2005	2006	2005
	US$000 Equivalent	US$000 Equivalent	US$000 Equivalent	US$000 Equivalent
Long /(short)				
Pound sterling	26,081	20,961	7,856	8,544
Euro	32,219	23,566	22,246	8,451
Others	2,438	8,843	-	-

32 **INTEREST RATE RISK**

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through a variety of means. The Bank's interest rate sensitivity position, based on the contractual repricing or maturity dates, whichever dates are earlier, is as follows:

2006

	Up to 1 month US$000	1 – 3 months US$000	3 - 6 months US$000	6 - 12 months US$000	1 – 3 years US$000	Fixed rate US$000	Non-interest bearing US$000	Total US$000
Cash and deposits with banks	66	-	-	-	-	10,493	2,149	12,708
Trading equities and funds	-	-	-	-	-	-	8,506	8,506
Government Bonds	-	-	-	-	-	4,388	-	4,388
Other equities and funds	-	-	-	-	-	-	75,690	75,690
Other bonds	574	-	-	-	-	9,113	-	9,687
Loans and advances	2,400	-	-	-	-	-	822	3,222
Instalment sale receivable	-	-	-	-	-	20,311	-	20,311
Fixed assets	-	-	-	-	-	-	12,796	12,796
Other assets	-	-	-	-	-	-	25,358	25,358
Total assets	3,040	-	-	-	-	44,305	125,321	172,666
Customer deposits	23,847	-	-	-	-	23,101	647	47,595
Securities sold under repurchase agreements	3,700	-	-	-	-	-	-	3,700
Medium term loan	-	43,700	-	-	-	-	-	43,700
Revolving loan facility	13,600	-	-	-	-	-	-	13,600
Other liabilities	-	-	-	-	-	-	7,644	7,644
Subordinated loans	-	-	-	-	-	10,000	-	10,000
Shareholders' equity	-	-	-	-	-	-	46,427	46,427
Total liabilities and shareholders' equity	41,147	43,700	-	-	-	33,101	54,718	172,666
Total interest rate sensitivity gap	(38,107)	(43,700)	-	-	-			
Cumulative interest rate sensitivity gap	(38,107)	(81,807)	(81,807)	(81,807)	(81,807)			

32 **INTEREST RATE RISK (CONTINUED)**

2005

	Up to 1 month US$000	1 – 3 months US$000	3 - 6 months US$000	6 - 12 months US$000	1 – 3 years US$000	Fixed rate US$000	Non-interest bearing US$000	Total US$000
Cash and deposits with banks	66	-	-	-	-	12,114	1,083	13,263
Trading equities and funds	-	-	-	-	-	-	7,234	7,234
Government bonds	-	-	-	-	-	-	-	-
Other equities and funds	-	-	-	-	-	-	87,804	87,804
Other bonds	864	-	-	-	-	8,945	-	9,809
Loans and advances	-	-	-	-	-	-	7,715	7,715
Instalment sale receivable	-	-	-	-	-	21,869	-	21,869
Fixed assets	-	-	-	-	-	-	11,136	11,136
Other assets	-	-	-	-	-	-	9,581	9,581
Total assets	930	-	-	-	-	42,928	124,553	168,411
Customer deposits	23,660	-	-	-	-	29,711	787	54,158
Securities sold under repurchase agreements	3,700	-	-	-	-	-	-	3,700
Medium term loan	-	53,200	-	-	-	-	-	53,200
Revolving loan facility	13,600	-	-	-	-	-	-	13,600
Other liabilities	-	-	-	-	-	-	6,505	6,505
Subordinated loans	-	-	-	-	-	10,000	-	10,000
Shareholders' equity	-	-	-	-	-	-	27,248	27,248
Total liabilities and shareholders' equity	40,960	53,200	-	-	-	39,711	34,540	168,411
Total interest rate sensitivity gap	(40,030)	(53,200)	-	-	-			
Cumulative interest rate sensitivity gap	(40,030)	(93,230)	(93,230)	(93,230)	(93,230)			

32 INTEREST RATE RISK (CONTINUED)

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

2006	Effective interest rate %		
	US$	GBP	EUR
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			
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	-	-

2005	Effective interest rate %		
	US$	GBP	EUR
Assets			
Placements with banks	4.3	-	2.4
Other bonds	3.7	5.4	-
Instalment sale receivable	4.8	-	-
Liabilities			
Customer deposits	3.9	4.4	1.6
Securities sold under repurchase agreements	4.4	-	-
Medium term loan	6.0	-	-
Revolving loan facility	4.4	-	-
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$ 647,000 (31 December 2005: US$ 787,000).
(d) 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

33 LIQUIDITY RISK

Liquidity risk is the possibility of the Group being unable to settle its present and future financial obligations. It includes the risk of being unable to fund the portfolio of assets at appropriate maturities and the risk of being unable to realise the stock of liquid assets at desired prices in an unfavourable market. The Group manages its liquidity risk through appropriate diversification of its financial assets and liabilities.

As outlined in note 14, in December 2004 the Bank signed an agreement with its lenders for refinancing of the US$ 75,000,000 medium term facility which matured in December 2002. This development accompanied by the raising of US $52,300,000 in new capital in July 2005 and the securing of a US $20,000,000 secured revolving term liquidity facility has significantly improved the liquidity position of the Bank and enable it to execute its business plan.

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

2006

	Within 1 month US$000	1 - 3 months US$000	3 - 6 months US$000	6 - 12 months US$000	1-5 years US$000	5-10 years US$000	10-20 years US$000	Over 20 years US$000	Total US$000
Assets									
Deposits with banks	12,708	-	-	-	-	-	-	-	12,708
Trading equities and funds	8,506	-	-	-	-	-	-	-	8,506
Government Bonds	-	-	-	-	-	-	-	4,388	4,388
Other equities and funds	-	11,365	8,553	21,168	16,189	18,415	-	-	75,690
Other bonds	-	-	-	-	9,113		-	574	9,687
Loans and advances	280	1,300	582	530	530	-	-	-	3,222
Instalment sale receivable	-	-	1,471	-	6,632	10,270	1,938	-	20,311
Fixed Assets	-	-	-	-	197	-	-	12,599	12,796
Other assets	17,326	2,728	856	329	4,119	-	-	-	25,358
Total assets	38,820	15,393	11,462	22,027	36,780	28,685	1,938	17,561	172,666
Liabilities									
Customer deposits	31,293	36	-	-	16,266	-	-	-	47,595
Securities sold under repurchase agreements	3,700	-	-	-	-	-	-	-	3,700
Medium term loan	-	-	15,200	-	28,500	-	-	-	43,700
Revolving loan facility	-	-	-	13,600	-	-	-	-	13,600
Subordinated loans	-	-	-	-	10,000	-	-	-	10,000
Other liabilities	2,057	408	413	286	3,405	1,075	-	-	7,644
Shareholders' equity	-	-	-	-	-	-	-	46,427	46,427
Total liabilities and shareholders' equity	37,050	444	15,613	13,886	58,171	1,075	-	46,427	172,666
Net liquidity gap	1,770	14,949	(4,151)	8,141	(21,391)	27,610	1,938	(28,866)	

Structured products (loans and receivables), included in Other bonds, of US$ 5,000,000 classified within the maturity band of 1 year to 5 years is a marketable security readily convertible to cash.

33 **LIQUIDITY RISK (CONTINUED)**

2005

	Within 1 month US$000	1 - 3 months US$000	3 - 6 months US$000	6 - 12 months US$000	1-5 years US$000	5-10 years US$000	10-20 years US$000	Over 20 years US$000	Total US$000
Assets									
Deposits with banks	13,263	-	-	-	-	-	-	-	13,263
Trading equities and funds	7,234	-	-	-	-	-	-	-	7,234
Government bonds	-	-	-	-	-	-	-	-	-
Other equities and funds	-	21	5,708	20,544	50,904	10,627	-	-	87,804
Other bonds	-	-	-	-	-	8,945	-	864	9,809
Loans and advances	-	739	2,588	-	-	-	-	4,388	7,715
Instalment sale receivable	-	-	-	1,558	6,324	9,795	4,192	-	21,869
Fixed assets	-	-	-	-	211	-	-	10,925	11,136
Other assets	948	4,760	415	195	3,263	-	-	-	9,581
Total assets	21,445	5,520	8,711	22,297	60,702	29,367	4,192	16,177	168,411
Liabilities									
Customer deposits	12,282	21,672	-	-	20,204	-	-	-	54,158
Securities sold under repurchase agreements	3,700	-	-	-	-	-	-	-	3,700
Medium term loan	-	-	-	9,500	43,700	-	-	-	53,200
Revolving loan facility	-	-	-	13,600	-	-	-	-	13,600
Subordinated loans	-	-	-	-	10,000	-	-	-	10,000
Other liabilities	23	306	413	1,502	350	1,406	1,000	1,505	6,505
Shareholders' equity	-	-	-	-	-	-	-	27,248	27,248
Total liabilities and shareholders' equity	16,005	21,978	413	24,602	74,254	1,406	1,000	28,753	168,411
Net liquidity gap	5,440	(16,458)	8,298	(2,305)	(13,552)	27,961	3,192	(12,576)	

Structured products (loans and receivables), included in Other bonds, of US$ 5,000,000 classified within the maturity band of 5-10 years is a marketable security readily convertible to cash.

34 MARKET RISK

Market risk is defined as the potential adverse changes in the value of a portfolio of financial instruments resulting from the movement of market rates, prices and volatilities. The Bank uses the standardised approach to measure the market risk-weighted assets for regulatory purposes. Additionally, the Bank employs a sophisticated risk management model that uses the RiskMetrics™ methodology to calculate market risk for internal risk measurement and management purposes. Market Risk is measured as "Value at Risk" (VaR) using probability analysis based upon a common confidence interval and time horizon. The VaR number is a statistical risk measure, which quantifies, within a given confidence level, the maximum fluctuation in portfolio value within a specified time period.

The Group's policy is to manage its exposure to market risk on an aggregate basis combining the effects of cash instruments and derivative contracts. The Group develops and refines hedging strategies that correlate price and currency movements of assets and liabilities and related hedges. In certain instances, derivative financial instruments are used to hedge other on and off balance sheet transactions.

Due to the lack of sufficient trading lines, the Bank was unable to undertake market risk mitigation activities.

35 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 2006 and 2005. 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.

2006	Book amount	Fair value	Over/(under) book amount
	US$000	US$000	US$000
Assets			
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	-
			(2,418)
Net shortfall of fair value over book amount			

2005	Book amount	Fair value	Over/(under) book amount
	US$000	US$000	US$000
Assets			
Other bonds carried at amortised cost	9,809	8,654	(1,155)
Loans and advances	7,030	7,030	-
Instalment sale receivable	21,869	21,869	-
Net shortfall of fair value over book amount			(1,155)

The total shortfall in fair value of US$ 2,418,000 (2005: US$ 1,155,000) 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.

35 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

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.

36 SEGMENTAL 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.

	Banking					
	Trading activity US$000	Investing activity US$000	Other operations US$000	Total Banking US$000	Manufacturing US$000	Total US$000
2006						
OPERATIONAL INCOME						
Segmental income/(loss)	8,033	19,864	4,659	32,556	(213)	32,343
RESULT						
Segmental result	8,033	12,577	1,733	22,342	(1,227)	21,115
NET INCOME/(LOSS)				22,342	(1,227)	21,115
OTHER INFORMATION						
Segmental assets	9,275	125,238	-	134,513	307	134,820
Unallocated corporate assets	-	-	-	37,846	-	37,846
CONSOLIDATED TOTAL ASSETS	9,275	125,238	-	172,359	307	172,666
Segmental liabilities	-	118,595	-	118,595	407	119,002
Unallocated corporate liabilities	-	-	-	7,237	-	7,237
	-	118,595	-	125,832	407	126,239
Shareholders' equity						46,427
CONSOLIDATED TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY						172,666

36 **SEGMENTAL INFORMATION (CONTINUED)**

	Banking					
	Trading activity	Investing activity	Other operations	Total Banking	Manufacturing	Total
	US$000	US$000	US$000		US$000	US$000
2005						
OPERATIONAL INCOME						
Segmental income/(loss)	(3,326)	20,699	2,792	20,165	(1,949)	18,216
RESULT						
Segmental result	(3,326)	13,199	803	10,676	(4,511)	6,165
NET INCOME/(LOSS)				10,676	(4,511)	6,165
OTHER INFORMATION						
Segmental assets	7,919	139,697	-	147,616	538	148,154
Unallocated corporate assets	-	-	-	20,257	-	20,257
CONSOLIDATED TOTAL ASSETS	7,919	139,697	-	167,873	538	168,411
Segmental liabilities	-	134,658	-	134,658	537	135,195
Unallocated corporate liabilities	-	-	-	5,968	-	5,968
	-	-	-	140,626	537	141,163
Shareholders' equity						27,248
CONSOLIDATED TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY						168,411

(b) **Geographical Segments**

	North America		Europe		Rest of the world		Total	
	2006	2005	2006	2005	2006	2005	2006	2005
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Income								
Total operating income/(loss)	8,802	8,628	20,469	19,217	3,072	(9,629)	32,343	18,216
Assets								
Total assets	50,094	53,033	48,097	56,244	74,475	59,134	172,666	168,411

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

37 PRIOR YEAR ADJUSTMENT AND RESTATEMENT OF PREVIOUS YEAR'S INCOME

Until 31 December 2005, the Bank carried its investments in private equity funds at fair value based on the net asset values reported by the fund managers as adjusted for management fees deemed recoverable. During the year, the Bank undertook a detailed review of its investment valuations in each of its private equity funds and determined that the fair value of the Bank's share of each investment in the funds should be determined on an individual investment basis.

As a result of this analysis the Bank identified that the fair value reserve included the cumulative effects of impairment, writedowns and management fees, which should have been reflected in prior years' income statements.

The required adjustments identified have an effect on the opening fair value reserve and retained earnings balances brought forward as at 1 January 2005, as well as in the net income for the year ended 31 December 2005 as set out below:

(a) Prior years adjustment in Balance Sheet

	Fair value reserve US$ 000	Retained earnings US$ 000	Total US$ 000
Balance at 1 January 2005 as previously reported	(12,973)	(104,639)	(117,612)
Prior year adjustment	24,061	(24,061)	-
Restated balance at 1 January 2005	11,088	(128,700)	(117,612)

The above adjustments have been disclosed in the Consolidated Statement of Changes in Shareholders' Equity.

(b) Restatement of 2005 Income Statement and Fair Value Reserve in Balance Sheet

	Impairment provisions US$ 000	Total operating expenses US$ 000	Net income for the year US$ 000	Fair value reserve in Balance Sheet US$ 000
As reported in the Financial Statement	(1,669)	(10,448)	7,768	(18,731)
Prior year adjustment at 1 January 2005	-	-	-	24,061
Adjustment to income for the year 2005	(1,603)	(1,603)	(1,603)	1,603
Restated amounts	(3,272)	(12,051)	6,165	6,933

Both the above adjustments do not impact the Bank's aggregate capital, net equity or the net carrying amounts of private equity investments of the Bank as previously reported.

38 CONSOLIDATED AVERAGE BALANCE SHEET

CONSOLIDATED AVERAGE BALANCE SHEET
AT 31 DECEMBER 2006
(Expressed in thousands of United States Dollars)

	2006	2005
Assets		
Cash and deposits with banks	10,520	17,832
Trading equities and funds	8,135	7,534
Government bonds	4,388	-
Other equities and funds	84,352	87,986
Other bonds	9,777	13,171
Loans and advances	3,309	8,806
Instalment sale receivable	20,701	22,044
Fixed assets	11,396	11,272
Other assets	14,284	10,404
Total assets	166,862	179,049
Liabilities and shareholders' equity		
Liabilities		
Customer deposits	50,645	70,440
Securities sold under repurchase agreements	3,700	6,200
Medium term loan	46,075	61,600
Revolving term loan	13,600	13,600
Other liabilities	7,049	6,874
Subordinated loans	10,000	20,000
Total liabilities	131,069	178,714
Shareholders’ equity	35,793	335
Total liabilities and shareholders’ equity	166,862	179,049