Report of the Auditors to the Shareholders

GULF FINANCE HOUSE B.S.C.

Manama, Kingdom of Bahrain

30 January 2005

We have audited the accompanying consolidated financial statements of Gulf Finance House B.S.C. ("the Bank") and its subsidiaries ("the Group") as at, and for the year ended, 31 December 2004 as set out on pages 54 to 85.

Respective responsibilities of directors and auditors

These consolidated financial statements and the Bank's undertaking to operate in accordance with Islamic Shari'a rules and principles are the responsibility of the directors of the Bank. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

Basis of opinion

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2004, the results of its operations, the changes in its cash flows, shareholders' equity, restricted investment accounts and sources and uses of charity fund for the year then ended, in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions, International Financial Reporting Standards and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

Other regulatory matters

In addition, in our opinion, the Bank has maintained proper accounting records and the financial statements are in agreement therewith. We have reviewed the accompanying report of the chairman and confirm that the information contained therein is consistent with the consolidated financial statements. To the best of our knowledge and belief, no violations of the Bahrain Commercial Companies Law 2001, the Bahrain Monetary Agency law 1973 (as amended) or the terms of the Bank's license or its memorandum and articles of association have occurred during the year that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by the management in response to all our requests.



KPMG

Manama, Kingdom of Bahrain

Consolidated Balance Sheet

as at 31 December 2004

US$ 000's

	Notes	2004	2003
ASSETS			
Cash and balances with Banks	3	4,287	21,087
Due from financial institutions	4	264,339	144,682
Investments in Sukuk	5	11,155	-
Available-for-sale investments	6	113,725	72,844
Investment property	7	-	4,126
Other assets	8	24,843	13,913
Equipment	9	2,089	827
Total assets		**420,438**	257,479
LIABILITIES			
Investors' funds	10	34,219	94,867
Due to financial institutions	11	23,359	17,548
Due to non-financial institutions	11	106,798	32,187
Other liabilities	12	7,464	7,491
Total liabilities		**171,840**	152,093
SHAREHOLDERS' EQUITY			
Share capital	13	139,973	65,198
Proposed increase in share capital		-	9,802
Share premium	13	31,487	-
Statutory reserve		10,576	4,792
Investments fair value reserve		3,347	1,440
Retained earnings		20,038	12,094
Proposed appropriations		43,177	12,060
Total shareholders' equity		**248,598**	105,386
Total liabilities and shareholders' equity		**420,438**	257,479
OFF-BALANCE SHEET ITEMS			
Restricted investment accounts (pages 58 and 59)		**602,212**	318,990

The consolidated financial statements, which consist of pages 54 to 85, were approved by the Board of directors on 30 January 2005 and signed on its behalf by:



Fuad Abdulla Al-Omar
Chairman



Adel Dawood Al-Ohali
Director



Esam Yousif A. Janahi
Chief Executive Officer

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

Consolidated Income Sheet

for the year ended 31 December 2004

US$ 000's

	Notes	**2004**	2003
Income from investment advisory services	14	75,302	32,697
Placement, arrangement and management fees		2,777	3,235
Commission income from sale of land		9,472	-
Income from Murabaha receivables		3,577	451
Income from available-for-sale investments	15	7,667	1,694
Other income		166	570
Total operating income		**98,961**	38,647
Staff costs	16	12,981	7,957
Investment advisory expenses		12,995	5,713
Impairment allowances on available-for-sale investments	6	9,424	5,000
Murabaha expense		2,102	332
Other operating expenses	17	4,010	2,180
Depreciation	9	544	391
Total operating expenses		**42,056**	21,573
PROFIT FOR THE YEAR		**56,905**	17,074
Earnings per share (US cents)			
Basic	30	**14.00**	7.28
Diluted	30	**14.00**	7.13

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

for the year ended 31 December 2004

US$ 000's

2004	Share Capital	Proposed increase in share capital	Share premium	Statutory reserve	Investments fair value reserve	Retained earnings	Proposed appropriations	Total
Balance at 1 January 2004	65,198	9,802	-	4,792	1,440	12,094	12,060	105,386
Issue of bonus shares	7,275	(7,275)	-	-	-	-	-	-
Shares Issued to Management Incentive programme for 2001 and 2002	2,527	(2,527)	-	-	-	-	-	-
Issue of new shares	56,000	-	35,487	-	-	-	-	91,487
Utilised to fund shares to MIP	4,000	-	(4,000)	-	-	-	-	-
Shares issued to Management Incentive Programme for 2003 and 2004	4,973	-	-	-	-	-	-	4,973
Dividend paid for 2003	-	-	-	-	-	-	(11,250)	(11,250)
Charity contribution declared (2003)	-	-	-	-	-	-	(450)	(450)
Board remuneration paid (2003)	-	-	-	-	-	-	(360)	(360)
Transfer to income statement on disposal of AFS investments	-	-	-	-	(458)	-	-	(458)
Net fair value changes during the year	-	-	-	-	2,365	-	-	2,365
Net profit for the year	-	-	-	-	-	56,905	-	56,905
2004 proposed appropriations								
Statutory reserve	-	-	-	5,784	-	(5,784)	-	-
Charity fund	-	-	-	-	-	(600)	600	
Board remuneration	-	-	-	-	-	(585)	585	-
Bonus shares	-	-	-	-	-	(9,798)	9,798	-
Dividends	-	-	-	-	-	(32,194)	32,194	-
Balance at 31 December 2004	**139,973**	**-**	**31,487**	**10,576**	**3,347**	**20,038**	**43,177**	**248,598**
2003								
Balance at 1 January 2003	65,198	939	-	3,085	1,861	8,787	7,825	87,695
Transfer	-	7,275	-	-	-	-	(7,275)	-
Charity contribution (2002)	-	-	-	-	-	-	(250)	(250)
Board remuneration (2002)	-	-	-	-	-	-	(300)	(300)
Management incentive plan	-	1,588	-	-	-	-	-	1,588
Transfer to income statement on disposal AFS investment	-	-	-	-	(420)	-	-	(420)
Net fair value changes during the year		-	-	-	(1)	-	-	(1)
Net profit for the year	-	-	-	-	-	17,074	-	17,074
2003 proposed appropriations :			-					
Statutory reserve	-	-	-	1,707	-	(1,707)	-	-
Charity fund	-	-	-	-	-	(450)	450	-
Board remuneration	-	-	-	-	-	(360)	360	-
Cash dividends	-	-	-	-	-	(11,250)	11,250	-
Balance at 31 December 2003	**65,198**	**9,802**	**-**	**4,792**	**1,440**	**12,094**	**12,060**	**105,386**

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows

for the year ended 31 December 2004

	Notes	2004	US$ 000's 2003
OPERATING ACTIVITIES			
Cash receipts from investment advisory services	14	37,374	32,443
Placement, management and arrangement fees received		2,777	3,235
Commissions received		9,472	-
Murabaha profits received		3,577	451
Murabaha expense paid		(2,101)	(332)
Income from available-for-sale investments received		5,935	424
Other income received		166	570
Payments for operating expenses		(21,649)	(13,852)
Cash flows from operating activities		**35,551**	22,939
INVESTING ACTIVITIES			
Purchase of available-for-sale investments	6	(30,926)	(17,132)
Proceeds from sale of available-for-sale investments	6	10,781	6,099
Sale/(Purchase)of investment property	7	4,126	(4,126)
Investors' funds(paid)/received, net	10	(60,648)	67,515
Purchase of equipment	9	(1,806)	(258)
Dividends received		1,274	883
Cash flows from investing activities		**(77,199)**	52,981
FINANCING ACTIVITIES			
Receipts from financial institutions, net	11	5,811	12,548
Receipts from non-financial institutions, net	11	74,611	21,903
Short term financing paid	8	(2,861)	(3,851)
Proceeds from advance towards share capital	13	-	2,911
Proceeds from issue of ordinary shares	13	88,576	-
Proceeds from employees' Murabahas		1,203	33
Cash paid to charitable organisations, net (page 60)		(70)	(39)
Board remuneration paid		(360)	(300)
Dividends paid		(11,250)	-
Cash flows from financing activities		**155,660**	33,205
Net increase in cash and cash equivalents		**114,012**	109,125
Cash and cash equivalents at 1 January		165,769	56,644
Cash and cash equivalents at 31 December		**279,781**	165,769
Cash and cash equivalents comprise:			
Cash and balances with banks	3	4,287	21,087
Due from financial institutions	4	264,339	144,682
Investments in Sukuk	5	11,155	-
		279,781	165,769

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Restricted Investment Accounts

for the year ended 31 December 2004

2004	Balance at 31 December 2003		
Company	**No of units (000)**	**Average value per share US$**	**Total US$ 000's**
Osoul House Ltd	1,258	8.31	10,456
Balexco House Ltd	1,846	10.88	20,084
Injazat Technology Fund EC	1,660	8.13	13,489
Gulf Coffee House Ltd	185	10.00	1,850
International Franchise Capital Ltd	768	10.00	7,699
Gulf Atlantic Real Estate Company Ltd	43,610	1.81	78,938
Aqar Management-1 Ltd	1,990	10.00	19,901
Bahrain Financial Harbour Inc	3,868	10.03	38,785
Gulf Atlantic FZ LLC	0.670	129,381.00	86,685
Al Sharq Ltd	15	10.00	150
Financial Centre Investment Company	4,095	10.00	40,953
Gulf Development Real Estate Company KSC(C)	-	-	-
Al Andalus House	-	-	-
Al Areen Investment Company	-	-	-
Menajet Investment Company	-	-	-
Legends Investment Company	-	-	-
Kuwait National Real Estate Investment and Services Company	-	-	-
			318,990

Note: revaluation gains of US$ 6,052 thousand and US$ 6,487 thousand arising on investments in Gulf Atlantic Real Estate Company Ltd and Gulf Atlantic FZ LLC respectively represent foreign exchange gains.

2003	Balance at 31 December 2002		
Company	**No of units (000)**	**Average value per share US$**	**Total US$ 000's**
Osoul House Ltd	1,258	10.45	13,148
Balexco House Ltd	1,684	10.68	17,984
Injazat Technology Fund EC	1,050	8.71	9,144
Gulf Coffee House Ltd	180	10.02	1,800
International Franchise Capital Ltd	768	10.00	7,686
Gulf Atlantic Real Estate Company Ltd	33,340	1.65	54,829
Aqar Management - 1 Ltd	-	-	-
Bahrain Financial Harbour Inc	-	-	-
Gulf Atlantic FZ LLC	-	-	-
Al Sharq Ltd	-	-	-
Financial Centre Investment Company	-	-	-
			104,591

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

US$ 000's

Movements during the year						Balance 31 December 2004			
Investment/ (withdrawal) US$ 000's	Revaluation US$ 000's	Gross income US$ 000's	Dividends paid US$ 000's	Bank's fees as an agent US$ 000's	Administration expenses US$ 000's	**No of units (000)**	**Average value per share US$**	**Total US$ 000's**	Total % ownership
-	2,653	-	(529)	-	-	1,258	10.00	12,580	77
(1,897)	(4,452)	-	(850)	-	-	1,656	7.78	12,885	53
11,050	-	-	-	-	-	2,765	8.87	24,539	75
-	-	-	-	-	-	185	10.00	1,850	90
(4,034)	-	3,842	-	-	-	768	9.77	7,507	67
-	6,052	7,143	(7,549)	-	-	43,610	1.94	84,584	91
-	-	1,898	(1,520)	-	-	1,990	10.19	20,279	90
2,012	-	58	-	-	-	4,069	10.04	40,855	100
2,712	6,487	9,131	(9,069)	-	-	0.690	139,053.00	95,946	100
-	-	-	-	-	-	15	10.00	150	6
44,275	-	305	-	-	-	8,523	10.04	85,533	99
3,320	-	-	-	-	-	9,784	0.34	3,320	7
35,235	-	61	-	-	-	3,524	10.02	35,296	90
137,050	-	478	-	-	-	13,705	10.03	137,528	99
2,000	-	-	-	-	-	200	10.00	2,000	34
32,273	-	29	-	-	-	3,227	10.01	32,302	99
5,058	-	-	-	-	-	13,550	0.3733	5,058	5
269,054	10,740	22,945	(19,517)	-	-			**602,212**	

US$ 000's

Movements during the year						Balance 31 December 2003			
Investment/ (withdrawal) US$ 000's	Revaluation US$ 000's	Gross income US$ 000's	Dividends paid US$ 000's	Bank's fees as an agent US$ 000's	Administration expenses US$ 000's	**No of units (000)**	**Average value per share US$**	**Total US$ 000's**	Total % ownership
-	(2,703)	529	(447)	(69)	(2)	1,258	8.31	10,456	77
1,621	594	1,001	(1,013)	(101)	(2)	1,846	10.88	20,084	73
6,100	(211)	(1,100)	-	(228)	(216)	1,660	8.13	13,489	77
50	-	-	-	-	-	185	10.00	1,850	90
-	-	13	-	-	-	768	10.02	7,699	65
18,299	6,070	6,654	(6,914)	-	-	43,610	1.81	78,938	91
19,900	-	1,184	(1,183)	-	-	1,990	10.00	19,901	90
38,683	-	102	-	-	-	3,868	10.03	38,785	99
84,514	-	3,757	(1,586)	-	-	0.670	129,381	86,685	95
150	-	-	-	-	-	15	10.00	150	6
40,950	-	3	-	-	-	4,095	10.00	40,953	99
210,267	3,750	12,143	(11,143)	(398)	(220)			318,990	

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

Consolidated Statement of Sources and Uses of Charity Fund

for the year ended 31 December 2004

		US$ 000's
	2004	2003
Sources of charity fund		
Contributions by the Bank	450	250
Non-Islamic income (note 21)	34	18
Total sources	**484**	268
Uses of charity fund		
Contributions to charitable organisations	(104)	(57)
Total uses	**(104)**	(57)
Excess of sources over uses	380	211
Undistributed charity fund at 1 January	475	264
Undistributed charity fund at 31 December (note 12)	**855**	475

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

1 INCORPORATION AND PRINCIPAL ACTIVITY

Gulf Finance House BSC ("the Bank") was incorporated in 1999 in the Kingdom of Bahrain under Commercial Registration No. 44136 as an "Exempt Company". In 2004, the Bank's legal status was changed to a stockholding company and its shares were listed on both the Bahrain and Kuwait Stock Exchanges. The Bank operates as an offshore Islamic Investment Bank under a license granted by the Bahrain Monetary Agency ("BMA").

The consolidated financial statements for the year ended 31 December 2004 comprise the financial statements of the Bank and its subsidiaries (together referred to as "the Group").

The Bank's activities are regulated by the BMA and supervised by a Religious Supervisory Board whose role is defined in the Bank's Memorandum and Articles of Association and the Religious Supervisory Board Report.

The principal activities of the Bank include investment advisory services and investment transactions which comply with Islamic rules and principles according to the opinion of the Bank's Shari'a Board.

The Bank's principal subsidiary companies as at 31 December 2004 were as follows:

Name	Country of incorporation	% holding	Nature of business
Gulf Finance House Commercial Bank BSC (c)	Bahrain	100	A commercial bank specialising in real estate financing.
Hawafiz BSC(c)	Bahrain	100	A SPV set up to hold the Bank's shares issued to employees as part of a Management Incentive Programme until they vest (refer note 18).
Al-Sharq Limited	Cayman Islands	84	A special purpose vehicle (SPV) set up to hold the Bank's investment in the equity of Halcore Group, Inc. a US leading manufacturer of ambulances and other medical transport and emergency.
Menajet Investment Company Limited	Cayman Islands	66	A special purpose vehicle (SPV) set up to hold the Bank's investment in the equity of Menajet Holding SAL, Lebanon, an airline and cargo services company operating in the Middle East and North African region.

The consolidated financials statements for the year ended 31 December 2004 include only the financial statements of the Bank, the financial statements of Gulf Finance House Commercial Bank BSC (c), and the financial statements of Hawafiz BSC (c). Investments in Al-Sharq Limited and Menajet Investment Company Limited have been accounted for as available-for-sale investments. (see accounting policy 2ci).

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been consistently applied by the Group and are consistent with those used in the previous year, except for accounting for the Management Incentive Programme expense, the impact of which has been disclosed in note (18).

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with both the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and International Financial Reporting Standards ('IFRS').

(b) Basis of preparation

The financial statements are presented in US Dollars, being the principal currency of the Group's operations. They are prepared on the historical cost basis except for the measurement at fair value of certain available-for-sale investments.

(c) Basis of consolidation

(i) Subsidiaries

Subsidiaries are those enterprises (including special purpose vehicles) controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases. Subsidiaries formed or acquired and held exclusively with the view to their subsequent disposal in the near future are not consolidated and are instead classified as available-for-sale investments and carried at fair value.

(ii) Associates

Associates are those enterprises in which the Bank has significant influence, but not control, over the financial and operating policies. Associates formed or acquired and held exclusively with the view to their subsequent disposal in the near future are not equity accounted and are instead classified as available-for-sale investments and carried at fair value.

(iii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are also eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(d) Foreign currency transactions

Transactions in foreign currencies are translated at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date, are translated at the exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the reporting currency at the exchange rates ruling at the dates that the values are determined.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Financial instruments

(i) Classification

Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturity dates that the Group has the positive intention and ability to hold to maturity. These include due from financial institutions and investments in Sukuk (Islamic bonds).

Available-for-sale investments are financial assets that are not held for trading purposes, originated by the Bank, or held to maturity. These include investments in quoted and unquoted equity investments.

(ii) Recognition

The Group recognises available-for-sale investments when it becomes entitled to ownership. This is determined based on either payments made to acquire stakes in investments or equity stakes received in kind for services rendered. From this date any gains and losses arising from changes in fair value of the assets are recognised.

Held-to-maturity investments are recognised on the day they are transferred to the Bank.

(iii) Measurement

Financial instruments are measured initially at cost, which is the fair value of the consideration given (in the case of an asset) or received (in the case of a liability), including transaction costs. Subsequent to initial recognition all available-for-sale assets are re-measured to fair value.

Held-to-maturity investments are measured at cost less any impairment allowances.

(iv) Gains and losses on subsequent measurement

Gains and losses arising from a change in the fair value of available-for-sale investments are recognised in a fair value reserve. When the investments are sold, impaired, collected or otherwise disposed of, the cumulative gain or loss previously recognised in the fair value reserve is transferred to the income statement.

(v) Fair value measurement principles

a) Unquoted available-for-sale investments

I. Available-for-sale investments for which there is no quoted market price or other appropriate methods from which to derive reliable fair values, are stated cost less impairment allowances.

II. For other unquoted available-for-sale investments, fair value is determined by reference the price of the most recent transactions in the shares, or based on management's assessment of the present value of future cash flows.

b) Quoted investments

III. Fair value for quoted available-for-sale investments is their market bid price.

(f) Cash and cash equivalents

Cash and cash equivalents comprise cash, balances with financial institutions and short-term highly liquid investments (including due from financial institutions and investments in Sukuk) with maturities of three months or less when acquired.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Impairment

The carrying amount of the Group's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement.

(h) Murabaha receivables

Murabaha receivables are stated at cost less impairment allowances.

(i) Investment in Mudaraba

Investment in Mudaraba is stated at cost less impairment allowances.

(j) Investments in Sukuk

Investments in Sukuk are stated at cost less impairment allowances.

(k) Equipment

Equipment is stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method to write-off the cost of the assets over their estimated useful lives ranging from 3 to 5 years.

(l) Investment property

Investment property is stated at cost less impairment allowances.

(m) Dividends and Board remuneration

Dividends to shareholders and board remuneration are recognised as liabilities in the period in which they are declared.

(n) Statutory reserve

The Bahrain Commercial Companies Law 2001 requires that 10 percent of the annual net profit be appropriated to a statutory reserve which is normally distributable only on dissolution. Appropriations may cease when the reserve reaches 50 percent of the paid up share capital.

(o) Revenue recognition

Income from investment advisory services is recognised when the services for the transaction are provided and income is earned. This is usually when the Group obtains from investors a legally binding and irrevocable commitment to subscribe for shares in an investment promoted by the Group. The Group then recognises revenue based on both the pro rata amount of such signed subscription agreements as of the reporting date and the terms specified in the private placement memorandum.

Income from investment advisory services is either received in cash or in kind (i.e. equity shares of the investment being promoted). Income received in kind is measured at the fair value of the consideration received.

Placement, management and arrangement fees and commissions are recognised as income when earned.

Income from Murabaha contracts recognised on a time-apportioned basis over the period of the contract.

Income from Sukuk is recognised on a time-apportioned basis over the term of the Sukuk.

Income from investments (**dividend income**) is recognised when the right to receive is established.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(p) Restricted investment accounts

Restricted investment accounts represents assets held in trust or in a fiduciary capacity by the Group for the benefit of the investment accounts holders. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders.

(q) Earnings prohibited by Shari'a

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Group uses these funds for charitable means. Movements in non-Islamic funds are shown in the statement of sources and uses of charity funds.

(r) Employees benefits

(i) Bahraini employees

Pensions and other social benefits for Bahraini employees are covered by the General Organisation for Social Insurance scheme, which is a "defined contribution scheme" in nature, and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis.

(ii) Expatriate employees

Expatriate employees on fixed contracts are entitled to leaving indemnities payable under the Bahraini Labour Law for the Private Sector of 1976, based on length of service and final remuneration. Provision for this unfunded commitment has been made by calculating the notional liability had all employees left at the balance sheet date.

(iii) Employee savings scheme

The Group has a voluntary employees saving scheme. The Bank and the employee contribute monthly on a fixed percentage of salaries basis to the scheme. The scheme is managed and administered by a board of trustees.

(s) Compensation benefits

Eligible employees are entitled to bonus in accordance with the Management Incentive Programme ("the Programme"). The total amount of the bonus is based on a percentage of the Bank's net profit in excess of a predetermined hurdle rate stated in the Bank's Articles of Association. Under the Programme, employees are entitled to receive bonus in the form of cash and shares in ratios determined by the terms of the Programme. Maximum shares of US$ 11,500 thousand are to be issued at par and vested to employees at stages in accordance with a pre-determined formula specified in the Programme. The total bonus is recognised as an expense and included in staff costs in the income statement.

(t) Zakah

In accordance with its articles of association, the Bank is not required to pay Zakah. However, the Bank is required to calculate and notify, under a separate report, individual shareholders of their pro-rata share of the Zakah payable amount. These calculations are approved by the Bank's Sharia Supervisory Board.

(u) Trade date accounting

All "regular way" purchases and sales of financial assets are recognised on trade date, i.e. the date that the Group contracts to purchase or deliver the asset. Regular way purchases or sale of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

US$ 000's

3 CASH AND BALANCES WITH BANKS

	2004	2003
Cash on hand and balances with Banks	4,234	21,034
Deposit with BMA	53	53
	4,287	21,087

4 DUE FROM FINANCIAL INSTITUTIONS

	2004	2003
Gross Commodity Murabaha	259,753	144,701
Less: Deferred income	(414)	(19)
	259,339	144,682
Investments in Mudaraba	5,000	-
	264,339	144,682

The average profit rate on Murabaha receivables as of 31 December 2004 was 1.68% per annum (2003: 1.25% per annum).

5 INVESTMENTS IN SUKUK

	2004	2003
Sukuk issued by the Bahrain Monetary Agency	5,573	-
Sukuk issued by a financial institution	5,582	-
	11,155	-

The average profit rate on BMA Sukuk as of 31 December 2004 was 2.2% per annum. The average profit rate on Sukuk issued by a financial institution as of 31 December 2004 was 2.2% per annum.

6 AVAILABLE-FOR-SALE INVESTMENTS

	2004	2003
At 1 January	72,844	62,344
Acquisitions during the year	58,721	23,400
Disposals during the year, at carrying value	(10,781)	(7,899)
Fair value changes during the year	2,365	(1)
	123,149	77,844
Less: Impairment allowances	(9,424)	(5,000)
At 31 December	**113,725**	72,844

6 AVAILABLE-FOR-SALE INVESTMENTS (continued)

		Country of incorporation	% ownership	Nature of main activities
Real estate sector				
Al-Khaleej Development Company BSC (c)		BAH	12.97	Investing in the real estate in the GCC countries.
Gulf Atlantic Real Estate Company Ltd		CI	8.96	SPV set up to invest in real estate in the United Kingdom.
Mina Manama Inc	A	CI	50.00	SPV set up to hold the Bank's and other investors' investment in Bahrain Financial Harbour Holding Company, a Bahraini joint stock company (closed), established to develop the Bahrain Financial Harbour project.
Gulf Development Real Estate		KW	13.84	Real estate and property development in Sultanate in Kuwait.
Kuwait National Real Estate Investment and Services Company		KW	5.48	Real estate and property development in Sultanate in Kuwait.
Al Areen Desert Spa and Resort Holding Company BSC (c)		BAH	6.67	Real estate and property development in Bahrain.
Al Areen Investment Company Ltd		CI	1.00	SPV set up to hold 60% of Al Areen Desert Spa and Resort Holding Company BSC (c).
Legends Holding Company		TBI	10.00	A company to be incorporated in UAE that will own the land site and undertake the development of the "Legends – Dubai", a real estate development project in UAE.
Al Andalus-House		CI	10.00	Investing in residential real estate development projects in Spain.
Aqar Management-I Ltd		CI	10.00	SPV set up to acquire a 90% equity stake in Benayat BSC, a closed Bahraini incorporated stockholding company that invest in real estate in Bahrain.
The Bunyan Fund		CI	7.27	Investing in multi-family residential construction projects in the USA.

6 AVAILABLE-FOR-SALE INVESTMENTS (continued)

		Country of incorporation	% ownership	Nature of main activities
Banking and Financial institutions				
Osoul House Ltd	A	BVI	23.00	SPV set up to hold the investment in Khaleej Finance and Investment Company BSC (c) , which is engaged in the provision of consumer finance in accordance with Islamic Sharia.
Al Fanar Lease Fund		CI	9.84	Open ended fund with the principal purpose of investing in diversified equipment leasing transactions in the USA.
Arab Finance House Inc		CI	7.50	SPV set up with the principal purpose of establishing Islamic Banks in Lebanon.
First Leasing Bank BSC (c)	A	BAH	22.5	Investment banking services
Solidarity BSC (c)		BAH	1.50	Takaful (Islamic insurance).
Trading and Manufacturing				
Balexco House Ltd	A	BVI	47.42	Special purpose vehicle (SPV) set up to hold the investment in Balexco BSC (c) whose principal activity is extrusion and sale of aluminium profiles
Al Sharq Ltd	S	CI	84.30	SPV set up to hold the investment in the Halcore Group, a US manufacturer of ambulances and other medical transport and emergency vehicles.
Balexco Qatar		TBI		Extrusion and sale of aluminium profiles
Technology sector				
Injazat Technology Fund E.C.	A	BAH	25.00	Investing in private equity within the technology sector in the Middle East and North Africa
Insiab Marketing Company Ltd		SA	14.50	Media
Others				
Gulf Coffee House Ltd		CI	10.00	SPV set up to hold the franchise rights of Costa Coffee in the GCC countries except Kuwait and the UAE.
Royal University for Women BSC (c)		BAH	5.00	A private women's university established in the Kingdom of Bahrain.
Menajet Investment Co.	S	CI	66.23	Airline and cargo services in the Middle East and North African region.
Al Batinah Development and Investment Holding Company		SO	13.75	Investment company.

BAH = Bahrain, BVI = British Virgin Islands, CI = Cayman Islands, KW = Kuwait, LEB = Lebanon, SO = Sultanate of Oman, SA = Saudi Arabia, UAE = United Arab Emirates
S = Subsidiary, A = Associate, TBI = To be incorporated

US$ 000's

7 INVESTMENT PROPERTY

	2004	2003
At 1 January	4,126	-
Additions	-	4,126
Disposal	(4,126)	-
At 31 December	-	4,126

During the year, the Bank sold its investment property to a related party. It consists of an investment in freehold land which was jointly owned with another related party. The title deed of the land was held by and registered in the name of the related party on behalf of the Bank.

8 OTHER ASSETS

	2004	2003
Project costs recoverable	850	1,547
Advisory fees recoverable	19,644	3,601
Short-term financing	2,861	3,851
Employee receivables	117	567
Murabaha - Management Incentive Programme	-	753
Dividends and other receivables	733	2,931
Prepayments and other receivables	638	663
At 31 December	**24,843**	13,913

Short term financing represents amounts advanced to related parties recoverable within six months.

US$ 000's

9 EQUIPMENT

	Furniture	Fixtures and equipment	Computers	Vehicles	2004 Total	2003 Total
Cost						
At 1 January	294	631	782	64	1,771	1,513
Additions	810	370	626	-	1,806	258
At 31 December	1,104	1,001	1,408	64	3,577	1,771
Depreciation						
At 1 January	173	382	362	27	944	553
Charge for year	149	147	236	12	544	391
At 31 December	322	529	598	39	1,488	944
Net book value At 31 December	**782**	**472**	**810**	**25**	**2,089**	827

10 INVESTORS' FUNDS

These represent funds received from investors to be invested in entities to be set up or promoted by the Group. The funds are invested in Murabaha transactions pending the legal formation of companies for these investments.

11 DUE TO FINANCIAL AND NON-FINANCIAL INSTITUTIONS

These comprise Murabaha payable to financial and non-financial institutions.

12 OTHER LIABILITIES

	2004	2003
Management incentive programme (note 18)	2,051	2,363
Advance towards share capital (note 13)	-	2,911
Employee accruals	650	671
Provision for employees' leaving indemnities	45	46
Charity fund (page 60)	855	475
Accounts payable	2,961	714
Accrued expenses	902	311
	7,464	7,491

13 SHARE CAPITAL

	2004	2003
Authorised:		
909,090,909 ordinary shares of US$ 0.33 each	**300,000**	150,000
Issued and fully paid up:		
424,159,124 ordinary shares of US$ 0.33 each	**139,973**	65,198

13 SHARE CAPITAL (continued)

During the year, the Bank's articles of association was amended to reflect the following changes:

- An increase in the authorised share capital from US$ 150,000 thousand to US$ 300,000 thousand.
- An increase in the issued and paid up capital from US$ 65,198 thousand to US$ 139,973 thousand through:
  - (i) issue of bonus shares of US$ 7,275 thousand;
  - (ii) issue of shares of US$ 2,527 thousand to the Management Incentive Programme;
  - (iii) issue of shares to existing and new investors of US$ 56,000 thousand at a premium of US$ 35,487 thousand, of which US$ 2,911 thousand was received in 2003 as advanced towards share capital;
  - (iv) issue of shares of US$ 4,000 thousand to the Management Incentive Programme funded from the share premium account pursuant to a resolution of the shareholders in 2003; and
  - (v) issue of shares of US$ 4,973 thousand to the Management Incentive Programme.

Additional information on shareholding pattern

(i) Names and nationalities of the major shareholders and the number of equity shares held in which they have an interest of 5% or more of outstanding shares.

	Nationality	No. of shares	% holding
Kuwait Finance and Investment Company	Kuwait	35,885,000	8.46
Gulf Investment House	Kuwait	29,734,109	7.01
Kuwait Finance House	Kuwait	27,178,181	6.41
Abdul Latif Al Shaya & Abdul Aziz Al Shaya	Kuwait	23,184,251	5.47
Bahrain Islamic Bank	Bahrain	22,568,084	5.32

(ii) The Bank has only one class of equity shares and the holders of these shares have equal voting rights.

(iii) Distribution schedule of equity shares, setting out the number of holders and percentage in the following categories:

Categories*	Number of Shares	Number of shareholders	% of total outstanding shares
Less than 1%	173,554,749	567	**40.92**
1% up to less than 5%	112,054,750	14	**26.42**
5% up to less than 10%	138,549,625	5	**32.66**
	424,159,124	586	100

* Expressed as a percentage of total outstanding shares of the Bank.

14 INCOME FROM INVESTMENT ADVISORY SERVICES

Included in income from investment advisory services, US$ 27,795 thousand (2003: US$ 6,268 thousand) which has been received by the Group in kind in exchange for investment advisory services rendered.

US$ 000's

15 INCOME FROM AVAILABLE-FOR-SALE INVESTMENTS

	2004	2003
Dividend income	1,274	883
Gain on disposal of available-for-sale investments	6,354	760
Income from managed funds	39	51
	7,667	1,694

16 STAFF COSTS

	2004	2003
Salaries and related expenses	6,188	4,472
Social insurance expenses	380	297
Management Incentive Programme (refer note 18)	5,426	2,235
Other staff expenses	987	953
	12,981	7,957

At 31 December the total number of staff employed by the Bank was as follows:

	2004	2003
Bahrainis	74	53
Expatriates	25	10
	99	63

17 OTHER OPERATING EXPENSES

	2004	2003
Premises	994	645
Telecommunication	143	120
Postage and courier	148	113
Printing and stationery	455	532
Professional fees	822	258
Shari'a Committee expenses	137	35
Board members expenses	619	214
Others	692	263
	4,010	2,180

18 MANAGEMENT INCENTIVE PROGRAMME

In accordance with its Articles of Association, the Bank has established a Management Incentive Programme ("the Programme"), which has been approved by the Bahrain Monetary Agency.

The annual amount of the bonus is based on a percentage of the Bank's net profit in excess of a predetermined hurdle rate as set out in the Bank's Articles of Association. As per the terms of the Programme, employees are entitled to receive bonus in the form of cash and shares in ratios determined by the terms of the Programme and as approved by the Board of Directors. Under the programme, maximum shares of US$ 11,500 thousand are to be issued at par and vested to the employees at stages in accordance with a pre-determined formula specified in the Programme.

The Group has incorporated a company, Hawafiz BSC (c) to hold the shares for the beneficial interest of the Programme until they vest.

The total bonus amount for 2004 was US$ 9,426 thousand (2003: US$ 2,235 thousand), of which US$ 4,000 thousand was funded from the share premium account pursuant to a shareholders' resolution in 2003 and the balance of US$ 5,426 thousand was charged to the 2004 income statement (note 16).

During 2004, the Board of Directors resolved to change the terms of the Programme and issue and vest to employees all the remaining shares under the Programme amounting to US$ 4,973 thousand, by 31 December 2004. Further, the Board also resolved to vest to employees, by 31 December 2004, all the shares previously issued under the Programme to Hawafiz BSC (c).

19 RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include entities over which the Group exercises significant influence, major shareholders, directors and executive management of the Group.

A significant portion of the Group's income from investment advisory services and placement and arrangement and management fees from entities over which the Group exercises significant influence.

Although these entities are considered related parties, the Group administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments. Consequently, the true nature of the Group's transactions with these entities is effectively conducted at commercial terms and conditions. The terms and conditions for these transactions are approved by the Board of Directors of the Group.

US$ 000's

19 RELATED PARTY TRANSACTIONS (continued)

The related party balances included in these consolidated financial statements are as follows:

	2004	2003
Assets		
Cash and balances with banks	2,037	83
Murabaha receivables	8,436	5,005
Available-for-sale investments	112,225	64,341
Investment property	-	4,126
Other assets	24,517	13,362
Liabilities		
Investors' funds	35,925	89,388
Due to financial institutions	19,355	10,008
Due to non-financial institutions	3,930	12,638
Other liabilities	4,568	3,034
Income		
Income from investment advisory services	81,306	32,697
Income from investments	9,472	229
Murabaha income	172	6
Income from available-for-sale investments	1,274	883
Expenses		
Staff costs	5,426	2,235
Investment related expenses	2,598	-
Impairment allowances on available-for-sale investments	9,424	2,000
Murabaha expenses	1,480	332
Other operating expenses	912	390

Details of Directors' interests in the Bank's ordinary shares as at the end of the year were :

	2004 No. of shares	2003 No. of shares
Dr. Fuad Abdulla Al-Omar, Chairman	3,339,142	303,030
Mohammed A Aziz Al-Alloush, Vice Chairman	175,000	303,030
Abdul Latif A Rahim Janahi	80,400	-
Adel Dawood Al-Ohali	5,564,219	3,636,364
Bader Jassim Bu-Rashid	80,400	-
Samir Yaqoob Al-Nafisi	85,000	-
Yousif Mohammed Khayat	100,000	-
Waleed A Rahman Al-Rowaih	85,000	-

US$ 000's

19 RELATED PARTY TRANSACTIONS (continued)

Details of material contracts involving directors' interests include:

	2004	2003
Directors' participation in investments promoted by the Bank (in US$000's)	421	50

20 ZAKAH

Zakah is directly borne by the shareholders and investors in restricted investment accounts. The Bank does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Religious Supervisory Board and notified to shareholders annually. Zakah payable by the shareholders in respect of the year ended 31 December 2004 was US cents 0.33 (2003: US cents 0.31) for every share held.

21 EARNINGS PROHIBITED BY SHARI'A

The Group receives interest from deposits placed with the Bahrain Monetary Agency and other incidental or required deposits. These earnings are utilised exclusively for charitable purposes and amounts to US$ 34 thousand (2003: US$ 18 thousand).

22 SHARI'A SUPERVISORY BOARD

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

US$ 000's

23 MATURITY PROFILE

2004	Up to 3 months	3 to 6 months	6 months to 1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and balances with banks	4,234	-	-	-	53	4,287
Due from financial institutions	264,339	-	-	-	-	264,339
Investments in Sukuk	11,155	-	-	-	-	11,155
Investment in subsidiaries	-	-	-	-	-	-
Available-for-sale investments	-	1,798	22,337	55,490	34,100	113,725
Other assets	24,843	-	-	-	-	24,843
Equipment	-	-	-	-	2,089	2,089
Total assets	**304,571**	**1,798**	**22,337**	**55,490**	**36,242**	**420,438**
Liabilities						
Investors' funds	34,219	-	-	-	-	34,219
Due to financial institutions	9,010	14,349	-	-	-	23,359
Due to non-financial institutions	2,857	31,997	71,944	-	-	106,798
Other liabilities	7,063	-	-	401	-	7,464
Total liabilities	**53,149**	**46,346**	**71,944**	**401**	**-**	**171,840**
Off-Balance sheet items						
Restricted investment accounts	7,507	-	14,885	421,130	158,690	602,212

2003	Up to 3 months	3 to 6 months	6 months to 1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and balances with banks	21,034	-	-	-	53	21,087
Murabaha receivables	144,431	251	-	-	-	144,682
Available-for-sale investments	-	1,751	8,959	50,780	11,354	72,844
Investment property	-	-	4,126	-	-	4,126
Other assets	13,913	-	-	-	-	13,913
Equipment	-	-	-	-	827	827
Total assets	179,378	2,002	13,085	50,780	12,234	257,479
Liabilities						
Investors' funds	94,867	-	-	-	-	94,867
Due to financial institutions	16,533	1,015	-	-	-	17,548
Due to non-financial institutions	10,978	8,571	12,638	-	-	32,187
Other liabilities	7,424	-	-	67	-	7,491
Total liabilities	129,802	9,586	12,638	67	-	152,093
Off-Balance sheet items						
Restricted investment accounts	-	-	-	30,540	288,450	318,990

US$ 000's

24 CONCENTRATION OF ASSETS, LIABILITIES AND RESTRICTED INVESTMENT ACCOUNTS

(a) Industry sector

2004	Trading and manufacturing	Banks and financial institutions	Real estate	Technology	Others	Total
Assets						
Cash and balances with banks	-	4,287	-	-	-	4,287
Due from financial institutions	-	264,339	-	-	-	264,339
Investments in Sukuk	-	11,155	-	-	-	11,155
Available-for-sale investments	19,902	15,281	65,280	8,823	4,439	113,725
Investment property	-	-	-	-	-	-
Other assets	66	1,479	21,935	77	1,286	24,843
Equipment	-	-	-	-	2,089	2,089
Total assets	**19,968**	**296,541**	**87,215**	**8,900**	**7,814**	**420,438**
Liabilities						
Investors' funds	115	199	33,098	-	807	34,219
Due to financial institutions	-	23,359	-	-	-	23,359
Due to non-financial institutions	-	-	75,880	-	30,918	106,798
Other liabilities	1,428	348	-	-	5,688	7,464
Total liabilities	**1,543**	**23,906**	**108,978**	**-**	**37,413**	**171,840**
Off-Balance sheet items						
Restricted investment accounts	**13,035**	**12,580**	**540,701**	**24,539**	**11,357**	**602,212**

US$ 000's

24 CONCENTRATION OF ASSETS, LIABILITIES AND RESTRICTED INVESTMENT ACCOUNTS (continued)

(a) Industry sector (continued)

2003	Trading and manufacturing	Banks and financial institutions	Real estate	Technology	Others	Total
Assets						
Cash and balances with banks	-	21,087	-	-	-	21,087
Murabaha receivables	-	144,682	-	-	-	144,682
Available-for-sale investments	23,340	15,734	20,424	8,930	4,416	72,844
Investment property	-	-	4,126	-	-	4,126
Other assets	3,074	1,593	6,002	98	3,146	13,913
Equipment	-	-	-	-	827	827
Total assets	**26,414**	**183,096**	**30,552**	**9,028**	**8,389**	**257,479**
Liabilities						
Investors' funds	-	4,346	83,067	-	7,454	94,867
Due to financial institutions	-	17,548	-	-	-	17,548
Due to non-financial institutions	-	-	12,638	-	19,549	32,187
Other liabilities	-	51	-	-	7,440	7,491
Total liabilities	**-**	**21,945**	**95,705**	**-**	**34,443**	**152,093**
Off-Balance sheet items						
Restricted investment accounts	**20,234**	**10,456**	**265,262**	**13,489**	**9,549**	**318,990**

US$ 000's

24 CONCENTRATION OF ASSETS, LIABILITIES AND RESTRICTED INVESTMENT ACCOUNTS

(continued)

(b) Geographic region

2004	GCC countries	Other MENA countries	UK	Europe (excluding UK)	USA	Total
Assets						
Cash and balances with banks	3,345	-	179	185	578	4,287
Due from financial institutions	206,911	-	-	26,705	30,723	264,339
Investments in Sukuk	11,155	-	-	-	-	11,155
Available-for-sale investments	82,914	9,000	8,230	3,915	9,666	113,725
Investment property	-	-	-	-	-	-
Other assets	19,026	1,293	2,114	2,410	-	24,843
Equipment	2,089	-	-	-	-	2,089
Total assets	**325,440**	**10,293**	**10,523**	**33,215**	**40,967**	**420,438**
Liabilities						
Investors' funds	31,312	551	-	2,356	-	34,219
Due to financial institutions	19,354	4,005	-	-	-	23,359
Due to non-financial institutions	106,798	-	-	-	-	106,798
Other liabilities	7,464	-	-	-	-	7,464
Total liabilities	**164,928**	**4,556**	**-**	**2,356**	**-**	**171,840**
Off-Balance sheet items						
Restricted investment accounts	384,236	2,000	84,584	131,242	150	602,212
2003						
Assets						
Cash and balances with banks	16,275	-	566	24	4,222	21,087
Murabaha receivables	116,057	-	-	12,565	16,060	144,682
Available-for-sale investments	43,213	7,500	7,644	2,523	11,964	72,844
Investment property	4,126	-	-	-	-	4,126
Other assets	7,867	1,286	1,123	3,187	450	13,913
Equipment	827	-	-	-	-	827
Total assets	**188,365**	**8,786**	**9,333**	**18,299**	**32,696**	**257,479**
Liabilities						
Investors' funds	93,857	1	-	1,009	-	94,867
Due to financial institutions	10,008	7,540	-	-	-	17,548
Due to non-financial institutions	32,187	-	-	-	-	32,187
Other liabilities	7,491	-	-	-	-	7,491
Total liabilities	**143,543**	**7,541**	**-**	**1,009**	**-**	**152,093**
Off-Balance sheet items						
Restricted investment accounts	**153,217**	**-**	**78,938**	**86,685**	**150**	**318,990**

US$ 000's

25 CURRENCY RISK

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank had the following significant net exposures denominated in foreign currency as of 31 December

	2004	2003
	US$ equivalent	US$ equivalent
Sterling Pounds	10,078	9,869
Euros	4,928	4,725
Lebanese Pounds	9,000	8,410
Kuwaiti Dinars	13,362	804
Other GCC Currencies (*)	70,739	46,398

(*) These currencies are pegged to the US Dollar.

26 LARGE EXPOSURES

Exposures to Banks and non-Banks which exceed 15% of the Bank's capital and reserves are as follows:

Bank exposures	**% of Tier 1 capital**	**2004**	% of Tier 1 capital	2003
Gulf International Bank BSC	16	40,618	-	-
National Bank of Kuwait	-	-	53	54,890
ABC Islamic Bank E.C.	-	-	16	16,132
Citibank N.A.	-	-	15	16,060

27 COMMITMENTS

The Bank's commitments to invest in projects at 31 December 2004 amounted to US$ 3,125 thousand (2003: US$ 19,983 thousand)

28 FAIR VALUE

Fair value is an amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Other than certain available-for-sale investments carried at cost of US$ 47,389 thousand (2003: US$ 22,124 thousand), the estimated fair values of the Group's other financial instruments are not significantly different from their book values.

29 RISK MANAGEMENT

The Group's exposure to risks and its approach to managing these risks are discussed below.

a) **Credit risk**

Credit risk is the risk that a counterparty to a financial transaction does not discharge its obligations on due dates and cause the other party to incur a financial loss. The Group's credit risk arises mainly from the advisory fee and other receivables, due from financial institutions and investments in Sukuk.

The Group has well defined policies for managing credit risks that ensure that risks are accurately assessed, properly approved and regularly monitored. Formal credit limits are applied at counterparty and single obligor level. Overall exposures are also evaluated to ensure a broad diversification of risk by setting concentration limits by geography and industry.

b) **Concentration risk**

Concentration risk arises when a number of counterparties are engaged in similar economic 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. The group seeks to manage its concentration risk by establishing geographic and industry wise concentration limits.

The geographical and industry wise distribution of assets and liabilities are set out in Note (24).

c) **Liquidity risk**

Liquidity risk is defined as the risk that the Group will not have funds available to meet liabilities as they fall due. The Group uses a maturity ladder approach for managing and monitoring the liquidity risk. It is the Group's policy to keep a significant part of its assets in highly liquid assets such as short term Murabahas and Sukuks.

The maturity profile of assets and liabilities is set out in Note (23).

d) **Profit rate risk**

Profit rate risk arises due to different timing of re-pricing of the Group's assets and liabilities. The Group's profit rate sensitive assets are mainly "due from financial institutions". The Group's exposure to profit rate risk is limited due to the short-term nature of "due from financial institutions".

e) **Currency risk**

The Group is exposed to currency risks on certain Murabaha receivables and available-for-sale investments. The Group seeks to manage currency risk by continually monitoring exchange rates.

US$ 000's

30 EARNINGS PER SHARE

Basic

Basic earnings per share is calculated by dividing the profit for the year by the weighted average number of equity shares outstanding during the year ended 31 December 2004 as follows:

	2004	2003
Profit for the year (US$ in 000's)	56,905	17,074
Weighted average number of equity shares (Nos. in 000's)	406,508	234,582
Basic earnings per share (in US cents)	14.00	7.28

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of equity shares outstanding to assume conversion of all dilutive potential equity shares. The shares to be issued under the management Incentive Progamme are considered to be dilutive potential equity shares. A calculation is done to determine the number of shares that could have been issued at par value based on the monetary value of liability under the Management Incentive Progarmme. The number of dilutive potential equity shares computed is adjusted to the weighted average number of equity shares to arrive at the dilutive earnings per share as follows:

	2004	2003
Profit for the year (US$ in 000's)	56,905	17,074
Weighted average number of equity shares (Nos. in 000's)	406,508	234,582
Weighted average shares to be issued under the Management Incentive Programme (Nos. in 000's)	-	4,831
Diluted weighted average number of equity shares (Nos. in 000's)	406,508	239,412
Diluted earnings per share (in US cents)	14.00	7.13

31 SOCIAL RESPONSIBILITY

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

32 IMPACT OF NEW INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

Following the revision of certain existing standards and issuance of new standards which will become applicable from 1 January 2005, the management has assessed the impact of adopting the following standards which are significant to the Group's operations and believe it will not have a material net impact on the Group's results and shareholders' equity. The applicable IFRS's are:

IFRS 2 "Share-Based Payments" ;
IAS 27 " Consolidated and Separate Financial Statements" ;
IAS 28 "Investments in Associates" and
IAS 39 "Financial Instruments: Recognition and Measurement"

33 COMPARATIVES

Certain comparative figures have been reclassified in order to conform with current year's presentation. Such reclassification did not affect previously reported net profit or shareholders' equity.

34 SUMMARISED FINANCIAL STATEMENTS OF GULF FINANCE HOUSE BSC, THE PARENT COMPANY

(i) Balance Sheet

US$ 000's

	2004	2003
ASSETS		
Cash and balances with banks	4,287	21,087
Due from financial institutions	264,339	144,682
Investments in Sukuk	11,155	-
Available-for-sale investments	103,800	64,419
Investments in subsidiaries, at cost	89,928	8,425
Investment property	-	4,126
Other assets	25,956	13,913
Equipment	2,089	827
Total assets	**501,554**	257,479
LIABILITIES		
Investors' funds	34,219	94,867
Due to financial institutions	103,541	17,548
Due to non-financial institutions	106,798	32,187
Other liabilities	7,459	7,491
Total liabilities	**252,017**	152,093
SHAREHOLDERS' EQUITY		
Share capital	139,973	65,198
Proposed increase in share capital	-	9,802
Share premium	31,487	-
Statutory reserve	10,576	4,792
Available-for-sale investments fair value reserve	3,347	1,440
Retained earnings	20,977	12,094
Proposed appropriations	43,177	12,060
Total shareholders' equity	**249,537**	105,386
Total liabilities and shareholders' equity	**501,554**	257,479
OFF-BALANCE SHEET ITEMS		
Restricted investment accounts	**602,212**	318,990

34 SUMMARISED FINANCIAL STATEMENTS OF GULF FINANCE HOUSE BSC, THE PARENT COMPANY (continued)

US$ 000's

(ii) Income statement

	2004	2003
Income from investment advisory services	75,302	32,697
Placement, management and arrangement fees	2,777	3,235
Commission income from sale of land	9,472	-
Income from Murabaha receivables	3,577	451
Income from available-for-sale investments	7,667	1,694
Other income	166	570
Total operating income	**98,961**	38,647
Staff costs	12,853	7,957
Investment advisory expenses	12,110	5,713
Impairment allowances on available-for-sale investments	9,424	5,000
Murabaha expense	2,283	332
Other operating expenses	3,902	2,180
Depreciation	545	391
Total operating expenses	**41,117**	21,573
PROFIT FOR THE YEAR	**57,844**	17,074
Earnings per share attributable to bank's shareholders (US cents)		
Basic	**14.23**	7.28
Diluted	**14.23**	7.13

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