

FINANCIAL REVIEW

FINANCIAL PERFORMANCE

Overview

The Bank achieved strong growth in earnings despite a challenging and difficult external business environment in the aftermath of the global financial crisis. Customer relationships were strengthened and as opportunities arose the Bank improved its business without compromising on risk criteria or pricing in line with the long-term objective of achieving a balanced relation between risk and returns. While the Bank generated increased earnings from continued growth in core banking businesses, it recorded some mark to market losses on managed funds and on its own initiative increased the level of general provision for impairment in loans and advances taking in to consideration the overall external credit environment and adopting a conservative and prudent approach to banking. As a result, the Bank achieved a Net Profit of BD 42.82 million for 2009, compared BD 34.74 million for 2008, an increase of 23.3 per cent.

At year-end 2009, the Bank's Total Assets stood at BD 2,117.75 million, compared to BD 2,034.10 million at year-end 2008. The growth in Total Assets was attributable mainly to a growth of 5.1 per cent in Loans and Advances portfolio and a strong growth of 21.0 per cent in Investments while the Bank deployed additional funds in Treasury bills and reduced inter-bank placements. Deposits was marginally lower by 2.6 per cent as the Bank made a conscious decision not to engage in price war with competitors for customer deposits as the Bank continues to have a comfortable liquidity position and a strong deposits base.

Key performance indicators remained strong with Return on Average Equity improving to 18.67 per cent for the year 2009 from 14.88 per cent for the year 2008. Also Earnings Per Share improved from 45 fils in 2008 to 55 fils for 2009. The Bank continues to have a strong capital adequacy ratio of 22.3 per cent calculated in accordance with Basel 2 and Central Bank of Bahrain guidelines. Liquidity continues to be comfortable with liquid assets (Cash and balances with central banks, Treasury bills and Placement with financial institutions) representing 21.4 per cent of total assets.

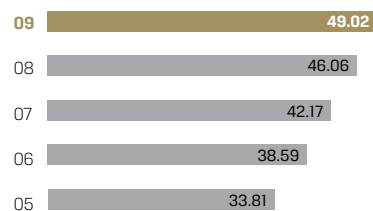
Net Interest Income

Net Interest Income at BD 49.02 million for the year reflects an increase of 6.4 per cent over 2008. The main drivers for the increase in Net Interest Income are growth in Loans and Investments despite lower yield on surplus liquidity deployed in money market and investments in a low interest rate environment.

As a result of better balance sheet management and tactical gapping strategies initiated by the Bank's Treasury & Investment group, the net interest margin, on average total assets, improved from 2.34 per cent in 2008 to 2.36 per cent in 2009.

Other Income

Total Other Income for the year was BD 23.26 million compared to BD 16.60 million for 2008, an increase of 40.1 per cent. This is on account of strong growth in business volumes from core banking activities, increase in foreign exchange activities and lower mark to market losses on managed funds.



NET INTEREST MARGIN
BD Millions

The Bank's continued emphasis on cost management and productivity improvements while generating higher operating income resulted in the operating efficiency ratio improving from 38.32 per cent in 2008 to 35.67 per cent in 2009.

Income stream of fees and commissions was in line with the expansion in business banking, retail lending and cards business activities.

Increased volume of foreign exchange business due to increased deal flows and offering of structured solutions to the specific needs of our clients resulted in exchange income increasing by 14.8 per cent to BD 4.43 million for 2009.

Details of Other Income, with comparative figures for the previous year, are set out in Note 23 to the Financial Statements.

Operating Expenses

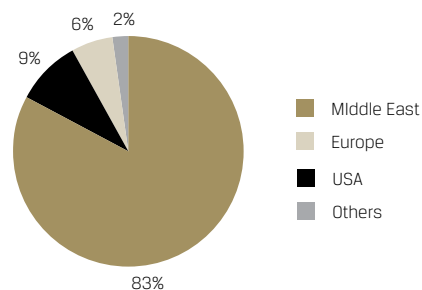
Operating Expenses at BD 25.78 million increased by 7.4 per cent over the previous year. Staff Expenses increased from BD 17.86 million in 2008 to BD 18.97 million in 2009 mainly on account of annual salary reviews, performance related rewards and addition to the Bank's human resources in line with the expansion in business. Other Operating Expenses increased marginally to BD 6.81 million in 2009 from BD 6.15 million in 2008 associated with system upgrades to improve operational efficiency and enhance customer service. The Bank's continued emphasis on cost management

and productivity improvements while generating higher operating income resulted in the operating efficiency ratio improving from 38.32 per cent in 2008 to 35.67 per cent in 2009.

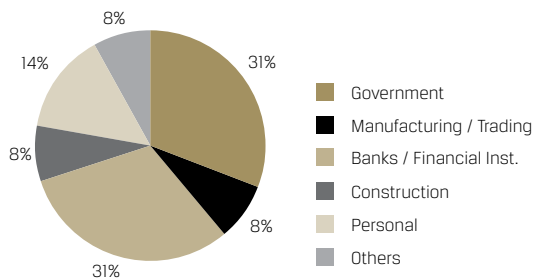
Provisions

In accordance with International Accounting Standard 39, the Bank follows a model-based approach for assessing the adequacy of provisions for loan losses. Provisions for individually significant credit exposures are determined by discounting expected future cash flows. Impairment and uncollectability is also measured on a portfolio basis, for a homogenous group of loans and advances not individually identified as impaired, on the basis of estimates of incurred losses inherent within the loans and advances portfolio that have not been specifically identified at the balance sheet date. The estimates are based on internal risk ratings, historical default rates adjusted considering current observable data, rating migrations, loss severity, macroeconomic outlook and other relevant factors that reflect the effect of current conditions on the loan book. Although there was no deterioration in the Bank's credit portfolio quality and concerted efforts were directed on recovering non-performing loans, the

FINANCIAL REVIEW



GEOGRAPHICAL DISTRIBUTIONS OF ASSETS



SECTOR WISE DISTRIBUTION OF ASSETS
Per cent

Bank on its own initiative decided to make a general provision of BD 3.50 million during the year 2009 in line with the Bank's prudent and conservative approach to risk considering the difficulties in the overall external credit environment and our emphasis on building up a strong balance sheet.

Non-performing loans decreased to BD 7.42 million, at the end of 2009 compared to BD 8.65 million at the end of 2008. The low levels of non-performing loans compared to the loan portfolio, is the result of the Bank's conservative credit risk policies, the effectiveness of credit risk management processes and the success of our recovery efforts. At year-end, the provision coverage ratio stands at 199.9 per cent. Details of the Bank's non-performing loans, provisions and movements therein during the year are detailed in Note 7 to the Financial Statements

ASSETS

Total Assets at BD 2,117.75 million, reflecting an increase of 4.1 per cent over 2008, is attributable mainly to a growth of BD 55.71 million in the Loans and Advances portfolio and BD 83.94 in Investments as the Bank diversified its funds deployment. At year-end 2009, Loans and Advances as a percentage of Total Assets was 54.4 per cent as compared to 53.9 per cent at

the end of year 2008. The proportion of Placements with Banks & Financial Institutions and Investment securities to Total Assets were 11.6 per cent 22.8 per cent respectively.

The increase in the loan book was mainly due to enhanced participation in the domestic market and broadening of business relationships in Bahrain in line with the Bank's strategy of focusing on the active sectors of the domestic economy. Loans and Advances portfolio is concentrated principally in Bahrain and other GCC countries. Based on contractual maturity terms, 42.5 per cent of the current portfolio matures within one year and 75.3 per cent is due to mature within 3 years of the balance sheet date.

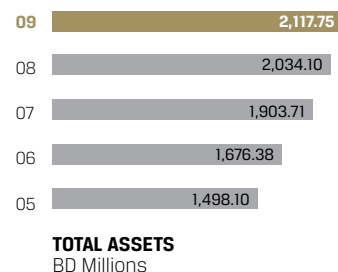
At the year-end, the Bank's Investment portfolio of BD 483.12 million (2008: BD 399.18 million) consisted of Available-for-Sale securities that comprised debt and equity securities while the Fair Value Through Profit and Loss investments comprised mutual funds and capital protected notes. A substantial portion i.e. 95.7 per cent of the total debt portfolio is in investment grade securities.

Notes 28 and 29 to the Financial Statements provide details of the distribution of Total Assets by geographical region and industry.

The Bank's capital adequacy ratio at the balance sheet date was 22.3 per cent which is well above the Basel requirement of 8 per cent.



The Bank has a stable and diversified customer base and the core deposits continue to grow.



LIABILITIES

Customer Deposits was marginally lower by 2.6 per cent to BD 1,480.39 million as at year-end 2009, from BD 1,519.25 million at the end of 2008. The Bank has a stable and diversified customer base and the core deposits continue to grow.

Borrowings under Repurchase Agreements and Due to Banks and Financial Institutions stood at BD 385.40 million at year-end 2009, compared to BD 285.78 million as at year-end 2008. Customers Deposits continue to be a major source of funding with the ratio of Customers' Deposits to Total Liabilities at 78.9 per cent at year-end 2009.

CAPITAL STRENGTH

Shareholders' Equity, inclusive of proposed appropriations, reflected a balance of BD 241.37 million. At the year-end, Shareholders' Equity as a percentage of Total Assets was 11.4 per cent.

The Bank's capital adequacy ratio at the balance sheet date was 22.3 per cent with Tier 1 ratio at 20.4 per cent. The ratios have been calculated in accordance with the Basel 2 and Central Bank of Bahrain guidelines.

The Bank's capital adequacy ratio, encompassing credit, operational and market risk, is well above the Basel requirement of 8 per cent and also comfortably above the minimum level of 12 per cent set by the Central Bank of Bahrain. Note 40 to the Financial Statements and Basel 2 – Pillar III disclosures provide further details on capital adequacy. The main factors that contribute to the Bank's strong capital adequacy ratio are high capital base, low levels of non performing assets that are fully provided for and the low risk profile of our on-balance sheet and off-balance sheet exposures which includes significant exposures to low risk weighted assets namely governments, public sector undertakings, banks and financial institutions.