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International Investment Bank

Annual Report 2006

International Investment Bank (IIB) was incorporated as an Islamic investment bank on 6 October 2003, under commercial registration number 51867 as a Bahrain Joint Stock Company (closed). The Bank commenced its investment activity on 13 October 2003, and operates under a Wholesale Banking Licence issued by the Central Bank of Bahrain.

IIB has an authorised capital of US\$ 200 million and a paid-up capital of US\$ 43 million. Subject to regulatory and shareholder approval, this is expected in the near future to increase to US\$ 100 million. The Bank's shareholders are high net worth individuals, business houses and institutions from the GCC states.

The core business activities of the Bank include investing on its own account; investment, underwriting and placement in real estate and private equity; and corporate finance, all in conformity with Islamic Shari'ah. It aims to offer its clients an internationally diversified range of investments generated through its network of strategic partnerships.

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To be a regional leader in private equity investment, real estate investment, asset management and corporate finance, mainly through the provision and management of high-quality, globally-diversified investment offerings in accordance with the principles of Islamic Shari'ah; to maximize shareholder value; to generate superior risk-adjusted returns for clients; to provide excellent career opportunities to all employees; and to deal fairly with all other stakeholders.

To originate, manage and ultimately exit from a well-diversified range of innovative investment products in association with leading international strategic partners; to provide high-quality advisory services to clients; to operate in accordance with the highest standards of corporate governance, risk management, due diligence and ethical standards; and to attract and retain the best-qualified employees available.

+92.2%

Net Income for the year rose by 92.2% over 2005 to US\$ 13.5 million

+49.2%

Total Assets increased by 49.2% over the year 2005 to reach US\$ 94.5 million

+54.5%

Total Assets under Management reached US\$ 181.7 million - up by 54.5% over 2005

+62.2%

Return on Average Equity increased by 62.2% during 2006 to 24.0%

+93.8%

Earnings per Share of US\$0.31 increased by 93.8% compared to 2005

Summary of Principal Investment Offerings 2004-2006

| | Year | Investment Description | Location | Private Equity Raised <i>US\$ Millions</i> | Other Funds ** <i>US\$ Millions</i> | Total Transaction Size <i>US\$ Millions</i> |
|---------------|--------|---------------------------------|--------------|---|---|--|
| 1 | 2004 | Property fund | Bahrain | 18.6 | 18.3 | 36.9 |
| 2 | 2004/5 | Independent power producer | Asia | 23.0 | 217.0 | 240.0 |
| 3 | 2005 | Housing development company | Bahrain | 22.6 | - | 22.6 |
| 4 | 2005 | Commercial property * | UK | 14.6 | 286.1 | 300.7 |
| 5 | 2005 | Commercial tower development * | Dubai | 16.4 | 77.7 | 94.1 |
| 6 | 2005 | Islamic investment bank | UK | 19.5 | 175.5 | 195.0 |
| 7 | 2005 | Paper manufacturing company | Abu Dhabi | 12.0 | 35.1 | 47.1 |
| 8 | 2006 | Commercial property portfolio | France | 44.0 | 61.6 | 105.6 |
| 9 | 2006 | Real estate development company | Saudi Arabia | 20.9 | 85.8 | 106.7 |
| 10 | 2006 | Commercial tower development | Dubai | 25.0 | 64.1 | 89.1 |
| Totals | | | | 216.6 | 1,021.2 | 1,237.8 |

* Investment realized and funds distributed to investors in 2006

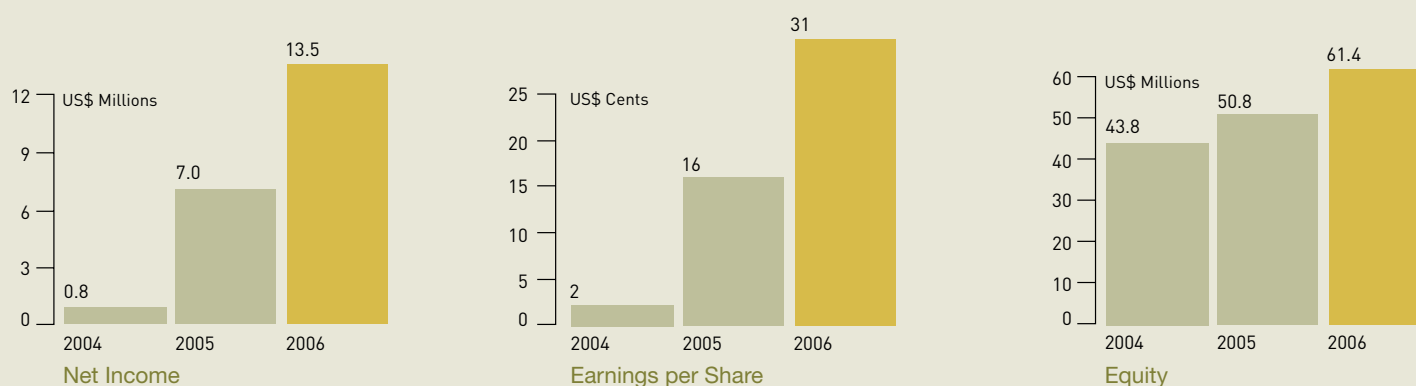
** Comprises partners' contributions, borrowings and equity from IPO

Principal Bankers and Professional Advisors

Principal Bankers Ahli United Bank, Bahrain

External Auditors Ernst & Young, Bahrain

External Legal Counsel Hassan Radhi and Associates, Bahrain



Three-year Financial Summary

| | 2006 | 2005 | 2004 |
|---------------------------------|------|------|------|
| Earnings (US\$ Millions) | | | |
| Total income | 24.6 | 12.4 | 4.2 |
| Operating income | 23.6 | 11.2 | 3.5 |
| Operating expenses | 10.1 | 4.2 | 2.7 |
| Net income | 13.5 | 7.0 | 0.8 |
| Dividend (%) | 10.0 | 8.0 | - |

Financial Position (US\$ Millions)

| | | | |
|---------------------------------|------|------|------|
| Total assets | 94.5 | 63.4 | 44.4 |
| Due from Financial Institutions | 53.5 | 26.2 | 28.0 |
| Investments | 16.4 | 13.7 | 14.1 |
| Due to Financial Institutions | 20.0 | - | - |
| Equity | 61.4 | 50.8 | 43.8 |

Ratios**Profitability**

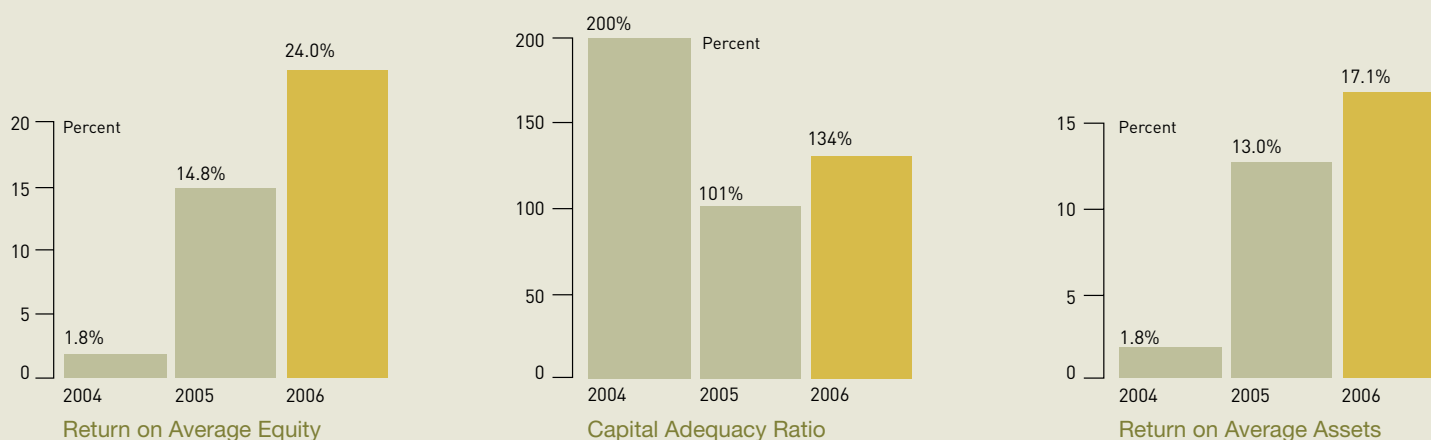
| | | | |
|------------------------------|------|------|------|
| Return on average equity (%) | 24.0 | 14.8 | 1.8 |
| Return on average assets (%) | 17.1 | 13.0 | 1.8 |
| Earnings per share (cents) | 31 | 16 | 2 |
| Cost-to-income ratio (%) | 45.2 | 43.5 | 81.5 |

Capital

| | | | |
|---|------|------|------|
| Capital adequacy (regulatory minimum 12%) | 134 | 101 | 200 |
| Equity/total assets (%) | 65.0 | 80.2 | 98.5 |

Liquidity and Other

| | | | |
|---|-------|-------|------|
| Investments/total assets (%) | 17.4 | 21.6 | 31.7 |
| Liquid assets/total assets (%) | 66.4 | 43.0 | 63.3 |
| Assets under management (US\$ Millions) | 181.7 | 117.6 | 19.6 |
| Number of employees | 40 | 20 | 17 |





Saeed Abdul Jalil Al Fahim

Dear Shareholders, On behalf of the Board of Directors, it gives me great pleasure to report to you on the performance of International Investment Bank ('IIB') during 2006.

Regional economic developments

As I foresaw in last year's Directors' Report, there were major corrections in the GCC stock markets during the course of the year, with some indices falling by more than 50% from their all-time highs only 12-15 months earlier. Although these falls have inevitably damaged investor confidence in the short term, they have not had a material impact on the overall economies of the region, which continue to be bolstered by high oil and gas revenues. Governments have exercised prudence in their spending, and have brought down their debt levels. They have also embraced a variety of economic and political reforms, which contributed to a favorable investment climate in IIB's target countries and sectors in 2006. However, the geopolitical situation in the wider Middle East region is a cause for concern, and could seriously dent investor confidence, not only in the Arab World but also internationally, if it deteriorates further.

Investment achievements

2006 was IIB's third full year of operations. In addition to arranging several new major real estate investments in Dubai, France and Saudi Arabia, the Bank made strategic direct investments in Islamic financial services institutions in the UK and Kuwait, which will complement its existing stake in European Islamic Investment Bank. IIB's investors and shareholders are already reaping the rewards of the Bank's highly selective and rigorous investment strategy, with two very profitable early exits being achieved from recent real estate

investments in the UK and Dubai. A 67% IRR was generated in only 18 months on the UK property, and the Dubai investment yielded a 25% IRR over a period of 11 months. These exits represented important milestones in IIB's development, as they are tangible evidence of the Bank's capabilities in delivering exceptional performance. IIB's strategy of investing across a diversified range of countries and industries has also paid dividends over the past year, as it has helped to cushion investors against the fall in the US Dollar.

Financial performance

Following the strong contribution from both the new and the existing investments arranged by the Bank, Total Income rose by 98.1%, from US\$ 12.4 million in 2005 to US\$ 24.6 million in 2006. During the year, IIB continued to build up its staff and its operating infrastructure, as a result of which Total Expenses increased by 105.8%. Net Income at US\$ 13.5 million was 92.2% higher than in 2005, representing a very creditable 31.3% return on paid-up capital. The Cost-to-Income Ratio increased from 43.5% in 2005 to 45.2% in 2006, which still compares very favorably with our regional and international peers.

The growth in business volumes was also reflected in the total footings increasing by 49.2% to US\$ 94.5 million. The Bank continued to maintain a high degree of liquidity, with surplus funds being placed on short term murabaha with selected investment-grade banks, and its Capital Adequacy Ratio remained comfortably above the regulatory requirement. This prudent approach to liquidity and solvency is a cornerstone of the risk management policy laid down by the Board of Directors, and is designed to ensure that IIB can withstand any external financial or economic shocks that may arise.

Given these excellent results, the Board is proposing to distribute a cash dividend for 2006 of US\$ 4.3 million, representing 10% of paid-up share capital, to transfer US\$ 1.3 million to statutory reserve and to retain US\$ 7.8 million to further strengthen the Bank's capital base. As in the previous two years, the Board is also proposing that the shareholders pay their respective Zakat on their equity investment in the Bank.

It is proposed that the Board of Directors should receive a total remuneration of US\$ 330,000 in respect of 2006, in addition to the usual reimbursement of their travel and accommodation expenses incurred in connection with IIB-related business during the year.

Capital increase

As announced at the last Annual General Meeting, it is intended to significantly increase the Bank's capital through a "rights issue" for existing shareholders and an invitation, on a selective basis, to certain investors in our deals to enable them to share in the success of the Bank. An independent valuation of the Bank is currently being undertaken by external consultants. Subject to final shareholder and regulatory approval, the capital increase is scheduled to proceed during the first half of 2007, and it will enable the Bank to scale up its activities in terms of both the number and the size of the transactions that it can arrange.

Outlook for 2007

Whilst the business prospects for 2007 appear bright, with a strong pipeline of deals already under review, and the regional economies remaining very buoyant, the Bank faces a number of challenges. Supported by the massive amount of liquidity and strong demand for Shari'ah-compliant investments in the GCC countries, there is intense competition from both regional and international investment banks for new business. This is driving down yields, and putting further upward pressure on regional and international asset prices, to levels which may not prove sustainable. There is also a shortage of qualified investment banking professionals, which has pushed up remuneration levels, and which could affect IIB's ambitious growth plans. The Bank is therefore introducing a share incentive scheme which is designed to attract and retain key staff, while aligning the interests of shareholders and employees.

During 2007 the Bank plans to acquire a core banking system in order to enhance and automate a number of its key processes, including accounting, financial control, risk management and customer relationship management. Whilst this will represent a major investment, it is considered essential to the Bank's long-term growth and development. Additional premises have also been leased in order to accommodate the Bank's increased headcount, which is expected to rise from 40 to 60 during 2007.

Appreciations

On behalf of the Board of Directors, I would like to thank the Bahrain Government and the Central Bank of Bahrain for their pro-active support for the financial services sector, and our shareholders, Shari'ah Board, clients, business partners and employees, who have all made invaluable contributions to IIB's success. We look forward to continuing our mutually beneficial relationship in the years ahead.

Saeed Abdul Jalil Al Fahim
Chairman



Mr. Saeed Abdul Jalil Al Fahim, Chairman

Chairman of Al Fahim Group, UAE; President of Sh. Khalifa Excellence Award (Abu Dhabi Chamber of Commerce and Industry); Former Deputy President of Abu Dhabi Chamber of Commerce and Industry; Former Member of Board of National Bank of Abu Dhabi; Former Member of Board of United Arab Bank.

| | | |
|---|---|---|
| 1 | 2 | 3 |
| 4 | 5 | 6 |
| 7 | 8 | 9 |

- 1 **Mr. Ahmed Salem Bugshan, Vice Chairman**
President, Saudi Industrial Projects Company (SIPCO), Saudi Arabia; Member of the Board, Pepsi Cola, Egypt; Chairman, Savoy Hotels, Sharm Al-Sheikh.
- 2 **Mr. Aamer Abdul Jalil Al Fahim, Director**
Managing Director of Al Fahim Group, UAE; Board Member of Abu Dhabi Commercial Bank; Board Member of Al Wathba Insurance Company; Member of Federal National Council, UAE; Board Member of Abu Dhabi Chamber of Commerce and Industry; Board Member of Al Qudra Holdings; Board Member of Al Safwa Islamic Financial Services; Chairman of Aradi Properties P.J.S.C.
- 3 **Mr. Ebrahim Eshaq Abdulrahman, Director**
Managing Director, Investment and Trading (Gulf) Enterprises, Bahrain; Director, Bahrain Car Park Co. B.S.C.; Director, United Gulf Industries B.S.C.; Founder Shareholder and former Managing Director of Bank of Bahrain and Kuwait.
- 4 **Mr. Abdul Wahab Mohammed Al Wazzan, Director**
Chairman of Kuwait Real Estate Bank; Chairman of Social Development Office, Kuwait; Vice Chairman of National International Holding Company, Kuwait; Former Minister of Commerce & Industry, Kuwait; Former Minister of Social Affairs & Labour, Kuwait.
- 5 **Mr. Ali Hashim Sadiq Hashim, Director**
President & CEO, Gulf United Investment, Saudi Arabia; Chairman, Gulf Packaging Systems, Saudi Arabia; Member of the Board, Middle East Telecom (METCO), Saudi Arabia.
- 6 **Mr. Khalid Othman Abu Hemed, Director**
President, Owma Trading Co. Ltd, Saudi Arabia.
- 7 **Mr. Abdulla Ahmed Balamsh, Director**
Proprietor and Chairman of Hosoon Najd Group, Saudi Arabia; Regional Manager of Saeed Mohammed Al-Amoudi Company; Member of the Board of Emmar Al Wattan Real Estate Company.
- 8 **Mr. Fahad Fouad Bubshait, Director**
Chairman & CEO of Audeo Maxima International Ltd., UAE; Chairman of BubbleDeck Middle East LLC, UAE; Foreign Investments Advisor of Abdulla Fouad Holding Co. Ltd.; Former General Manager of Mantech Real Estate & Fouad Travel Agency (Abdulla Fouad Holding Company Ltd.), Saudi Arabia.
- 9 **Mr. Sulaiman Haider Sulaiman, Director**
Chairman, Sulaiman & Bros, Qatar; Board Member, Qatar Chamber of Commerce; Board Member, Qatar Navigation; Board Member, Qatar German Medical Company; Area Manager, Qatar National Bank.



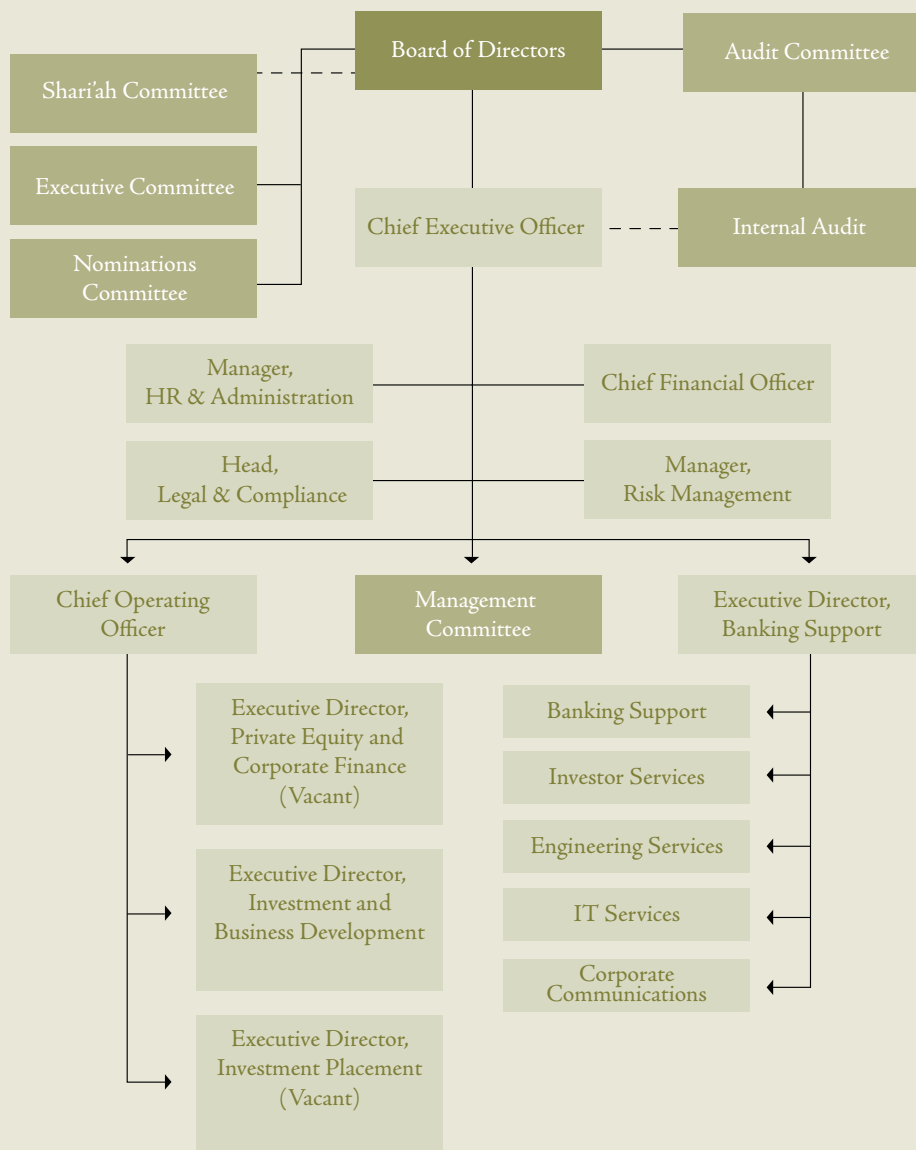
The Board of Directors is responsible for the overall governance of the Bank through continuous review and adherence to international best practice and standards. The Board determines the Bank’s strategy, provides direction to the Executive Management, ensures that the control framework is functioning in accordance with best practice and monitors Executive Management’s performance. The interaction between Directors and Management through the Board and Management Committees is shown on the organization chart.

1. Board of Directors

The Board meets regularly throughout the year in order to control strategic, financial, operational, internal control and compliance issues. It currently comprises ten “non-executive directors”, as defined by the “High Level Controls” module (HC-1.3.5) of the CBB Rulebook Volume II, profiles of whom are provided at Page 8.

Board Committees

The Board has established three sub-committees and a Shari’ah Board comprising expert, independent scholars to assist it in carrying out its responsibilities. The Nominations Committee was set up in 2006. This committee structure ensures appropriate oversight by the Board of Directors while permitting efficient day-to-day management of the Bank.



| Committee | Members | Summary Terms of Reference |
|----------------------------|--|---|
| Executive Committee | Mr. Aamer Abdul Jalil Al Fahim (Chairman) Mr. Ebrahim Eshaq Abdulrahman Mr. Khalid Othman Abu Hemed | Assists the Board to review the Bank’s strategy, annual budget and forecasts, risk policies and management committees’ activities and actions. |
| Audit Committee | Mr. Abdul Wahab Mohammed Al-Wazzan (Chairman) Mr. Sulaiman Haider Sulaiman, Mr. Fahad Fouad Bubshait | Assists the Board to review the integrity of the financial statements, compliance with legal and regulatory requirements, the Bank’s internal audit function and the independent auditor’s qualifications, independence and performance. |
| Nominations Committee | Mr. Ahmed Salem Bugshan (Chairman) Mr. Aamer Abdul Jalil Al Fahim Mr. Ali Hashim Sadiq Hashim | Assists the Board to assess candidates and to make management appointments. |
| Shari’ah Supervisory Board | Sheikh Nizam Yaquby (Chairman) Sheikh Abdul Sattar Abu Ghuddah Sheikh Osama Mohammed Saad Bahar | Assists the Board to ensure that the Bank operates in accordance with Shari’ah rules and principles through a review of interim and annual financial statements and a detailed analysis of each type of transaction with its relevant documentation and the procedures adopted by the Bank. |

Shari'ah Supervisory Board

Being an Islamic Bank, IIB's Shari'ah Supervisory Board regularly reviews all investment products and business activities to ensure compliance with the Islamic Shari'ah, approves the Bank's financial statements and also participates with management in the development of suitable investment products and services.

IIB's Shari'ah Supervisory Board comprises three prominent GCC Islamic scholars who provide the Bank with pragmatic Islamic opinions:

Sheikh Nizam Yaquby

Sh. Yaquby is a member of the Islamic supervisory board of several Islamic institutions, including the Arab Islamic Bank and the Abu Dhabi Islamic Bank. He is also a board member of the Dow Jones Islamic Index. His work has appeared in the following publications: *Risalah Fi al-Tawbah*, *Qurrat al-Ainayn fi Fada il Birr al-Walidayn*, *Irshad al-Uqala'ila Hukum al-Qira'h min al-Mushaf fi al-Salah*, *Tahqia al-Amal fi Ikhraj Zakat al-Fitr bi al-Mal*.

Sheikh Abdul Sattar Abu Ghuddah

Sh. Abu Ghuddah holds a Ph.D. in Islamic law and comparative Fiqh from Al Azhar University Cairo, Egypt. He has taught at various institutes, including Imam Al Da'awa Institute (Riyadh), Religious Institute (Kuwait) and the Shari'ah College of the Law Faculty at Kuwait University.

Sheikh Osama Mohammed Saad Bahar

Sh. Al Bahar holds a Bachelor degree in Islamic Shari'ah and was an Associate Lecturer at the BIBF, Bahrain. He is a Member of the Shari'ah Board of the National Investor Fund of Abu Dhabi and is a Shari'ah Advisor to Khaleej Finance and Investments. From 1994 to 2005, he was Manager of the Shari'ah Department at Shamil Bank, Bahrain. Since 2005, Sh. Osama has been Shari'ah Compliance Officer at ABC Islamic Bank, Bahrain and is currently Head of Shari'ah Compliance at Al-Salam Bank, Bahrain.

2. Executive Management

Management Committees

The Board has approved the formation of an Executive Management Committee, which is summarised in the table below.

Arising from the rapid growth in the Bank during its first three years of operations, a comprehensive review of corporate governance and the committee structure has been completed. It is anticipated that the Board at its next meeting will approve the formation of an Assets and Liabilities Committee, an Investment Committee and a Risk Management Committee, which are planned to be fully functional by 30 June 2007. These committees will comprise senior management and heads of departments who are best qualified to make decisions on such issues as funding, asset utilization, investment purchase/sale and management of all types of risk, including market, credit, liquidity and operational risks. In addition, an Information Technology Committee will be formed to supervise the selection and implementation of a core banking system.

A Management Committee will approve each committee's terms of reference, membership, delegated authorities and policies. All management committees are expected to meet at least monthly and a quarterly report highlighting the major activities and decisions will be provided to the Executive Committee for review and ratification. This enhanced structure will ensure that IIB meets or exceeds the best industry standards of governance and its activities, strategy, performance and risks are effectively managed.

| Committee | Members | Summary Terms of Reference |
|----------------------|---|---|
| Management Committee | Mr. Aabed Al-Zeera (Chairman) Mr. Salah Nooruddin Mr. Frederick Stonehouse Mr. Michael Ross-McCall Mr. Mohamed Hadi Mejai | Focuses on the execution of the strategic business plan via regular review and monitoring of the tasks and initiatives undertaken to fulfill the plan's objectives. |

Executive Management Profiles

a). General Management

Aabed Al-Zeera, Chief Executive Officer

Mr. Al-Zeera has over twenty five years of international banking experience with major financial institutions in the Kingdom of Bahrain and the United Arab Emirates. They include American Express Banking Corporation, Arab Banking Corporation (ABC), Standard Chartered Bank and First Islamic Investment Bank (now Arcapita). He was instrumental in setting up ABC's Representative Office in Abu Dhabi in 1996, where he served as Vice President and Chief Representative.

Mr. Al-Zeera was one of the key promoters of IIB who, together with the Al Fahim Group, conceived and successfully set up the Bank. He is a board member of several companies of IIB and is a Non-Executive Director of European Islamic Investment Bank Plc, London.

Salah Nooruddin, Chief Operating Officer

Mr. Nooruddin holds a Masters Degree in International Banking & Finance and has over twenty years of international banking experience with major financial institutions such as Chase Manhattan Bank and Arab Banking Corporation. In 1997, he established a financial advisory firm, Trust Securities, which is today known as Gulfinvest Bahrain. He joined IIB when operations commenced in 2003 and is a board member of several companies of IIB and of Islamic Finance Consultants.

Eihab Ahmed, Head, Legal & Compliance

Mr. Ahmed graduated in 1994 with a Law Degree from the University of Khartoum, following which he spent 5 years as Legal Consultant at the Ministry of Justice of Sudan. He was a Public Prosecutor and for four years a Legal Advisor at the Bank of Khartoum. He then worked as Legal Consultant at BDO Jawad Habib, Bahrain and most recently as Head of Legal Department at Khaleej Finance & Investment Bank, Bahrain.

b). Banking Support

Frederick Stonehouse, Executive Director

Mr. Stonehouse has more than 30 years of international banking experience with major UK, US, Arab and Spanish institutions in London, Bahrain and Madrid, including National Westminster Bank, Lloyds Bank International, Arab Banking Corporation, Arab Bank and Banco Atlantico. He has been closely involved with Arab institutions since 1978 and has occupied senior management positions for the past 20 years.

Hasan Abu-Hasan, Head, Engineering Services

Mr. Abu-Hassan holds a Master's Degree in Engineering Management from Bahrain University and a Master's Certificate in Project Management from The George Washington University School of Business. Prior to joining IIB in November 2005, as a Civil Engineer and a Government Executive, he spent more than 20 years working in developing the electricity and water infrastructures for the Kingdom of Bahrain.

c). Finance, Administration and Audit

Michael Ross-McCall, Chief Financial Officer

Mr. Ross-McCall holds a Law Degree from Edinburgh University and is a member of The Institute of Chartered Accountants of Scotland. He has worked in the banking sector for over 20 years, including positions at Wells Fargo Bank, Bank of Bahrain & Kuwait and Bahraini Saudi Bank.

Nader Asad, Director, Finance and Administration

Mr. Asad holds a B.Sc. in Accounting and an M.B.A. from a UK university. His professional qualifications include CPA and CFA. He spent eight years providing audit and advisory services at PricewaterhouseCoopers and Arthur Andersen and before joining the Bank in 2005, he was Deputy Financial Controller at Bahrain Islamic Bank.

Ali Redha, Head, Internal Audit

Mr. Redha is a member of the American Institute of Certified Public Accountants (AICPA). He has over 10 years of experience in auditing and banking at KPMG, Daar Al-Maal Al-Islami (DMI Group), Shamil Bank, Ithmaar Bank and Bahraini Saudi Bank. He joined IIB in 2005 and helped co-ordinate policies and procedures and the setup of controls and guidelines.

d). Investment and Business Development

Mohamed Hadi Mejai, Executive Director

Prior to joining IIB in 2005, Mr. Mejai spent several years with the Islamic Development Bank Group and affiliated investment companies and funds in the Kingdom of Saudi Arabia and UAE. He started his banking career in France and the UK. Mr. Mejai's track record is mainly in acquisition structuring and monitoring of investments. He holds a Masters of Science from the University of London, UK and completed his executive education at the Theseus International Institute, France, and the London Business School, UK.

Hakan Gunay, Director

Mr. Gunay holds a B.Sc. in Management from the Middle East Technical University in Turkey and an MBA from Cass Business School, London City University (UK). Prior to joining IIB, he spent 15 years in the field of appraisal, development and financing of infrastructure projects, located in Turkey, Belgium and Saudi Arabia.

3. Incentive Structure

The Bank conducts a formal written appraisal for management at least once per year. Depending on the Bank's performance and individual goal achievement, management and staff are eligible to receive an annual discretionary performance bonus and/or a salary increment. Management and staff are also eligible to co-invest in the Bank's investment offerings. The Board of Directors approves the aggregate amount of discretionary bonuses, together with the specific payments made (if any) to the Chief Executive Officer and the Chief Operating Officer. The Board approves the aggregate amount of planned increments as part of its approval of the annual budget.

A proposal to implement a stock option scheme available to management and selective staff will be presented to an extraordinary general meeting for approval during the first quarter of 2007.

4. Communications Strategy

A summary of the Bank's quarterly and annual financial statements are published in local and regional newspapers. All other published communications including investment offerings and exits are handled by the Corporate Communications Department, under the direction of the Executive Director, Banking Support. Enquiries are received via the IIB e-mail address enquiries@iib-bahrain.com.

The Bank maintains a website www.iib-bahrain.com which contains the latest Annual Report, together with summary financial data covering the previous two years and interim quarterly financial statements. It also contains a profile of the Bank, details of the principal products and services, profiles of the senior managers and regular press releases concerning investment transactions and other developments.

5. Additional Governance Controls

The Board has approved a number of policies which are communicated to management and all staff. They cover subjects including risk management, anti-money laundering, ethical behavior, personal conduct, financial control, human resources and business continuity.

Corporate governance is also supported by the ongoing reviews performed by the Internal Audit Department and the External Auditors. The reviews confirm that the policies and internal control procedures conform to best practice and are being fully complied with by all staff.

6. Shareholders and Directors' Interests

Shareholders

Distribution Schedule of Equity

The ordinary shares in issue at 31 December 2006 comprised 43 million shares of US\$ 1 each. The concentration of the 45 shareholders is as follows:

| Category | Number of Shares | Number of Shareholders | Percentage Holding |
|-------------------------|-------------------|------------------------|--------------------|
| Less than 1% | 2,550,000 | 12 | 5.93 |
| 1% up to less than 5% | 25,209,649 | 30 | 58.62 |
| 5% up to less than 10% | 4,801,754 | 2 | 11.17 |
| 20% up to less than 25% | 10,438,597 | 1 | 24.28 |
| Total | 43,000,000 | 45 | 100 |

Directors

Shareholding by Directors and their related parties

The number of shares held by Directors and their related parties at 31 December 2006 aggregated to 49.98% of the issued share capital.

7. Management Team

General Management

| | |
|-----------------|--------------------------|
| Aabed Al-Zeera | Chief Executive Officer |
| Salah Nooruddin | Chief Operating Officer |
| Eihab Ahmed | Head, Legal & Compliance |

Banking Support

| | |
|----------------------|--|
| Frederick Stonehouse | Executive Director, Banking Support |
| Murtaza Ghulam | Principal, Banking Support |
| Saba Al-Khalifa | Principal, Investor Services |
| Mazar Jalal | Principal, Acting Manager, Risk Management |
| Hasan Abu-Hasan | Head, Engineering Services |

Finance, Administration and Audit

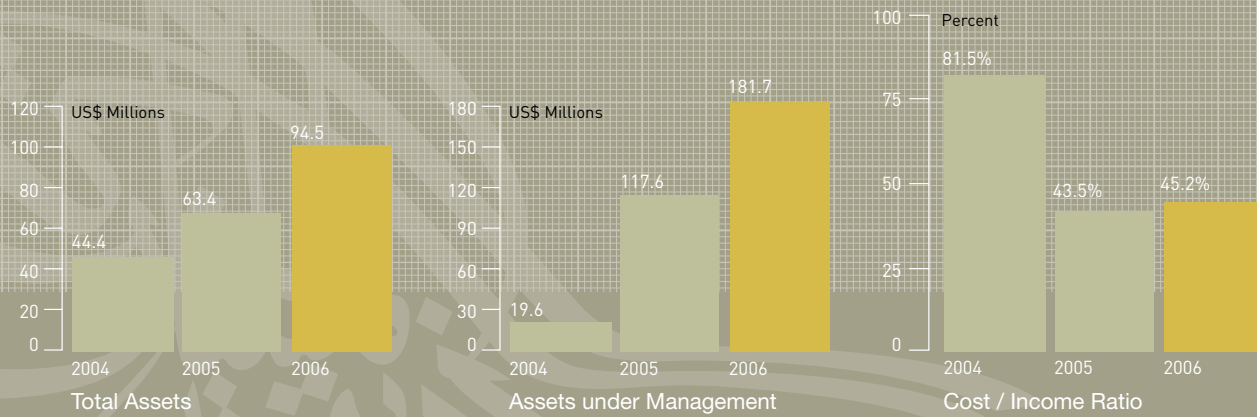
| | |
|---------------------|--------------------------------------|
| Michael Ross-McCall | Chief Financial Officer |
| Nader Asad | Director, Finance and Administration |
| Ali Redha | Head, Internal Audit |

Business Development

| | |
|--------------------|---|
| Mohamed Hadi Mejai | Executive Director, Investment & Business Development |
| Hakan Gunay | Director |
| Nader Al-Khillili | Principal |
| Nasser Bayoun | Principal |
| Fadi Qassim | Project Manager |

Investment Placement

| | |
|------------------------|---|
| Alyas Al-Meftah | Principal, KSA, Western Province |
| Ebrahim Al-Shaibeh | Principal, Kuwait |
| Fawzan Alnaser | Principal, Bahrain, Qatar and KSA, Eastern Province |
| Jassim Alshaikh | Principal, KSA, Riyadh |
| Rayan Kazerooni | Principal, UAE and Oman |
| Bader Ali | Associate, KSA Eastern Province |
| Bashar Ali Al-Shaikh | Associate, KSA Eastern Province |
| AbdulJabbar Al-Kooheji | Associate, UAE |
| Saud Al Yahya | Associate, Kuwait |





Aabed Al-Zeera

Bahrain's economy performed well in 2006 in conjunction with the robust growth in other GCC countries. This was supported by record oil prices and high production levels, strong corporate earnings, particularly in the banking sector, low inflation and high levels of liquidity. Most regional economies posted record budget and current account surpluses. Despite a number of IPOs that were oversubscribed, most regional stock market indices posted declines in 2006.

The Central Bank of Bahrain issued banking licenses to several new institutions during the year, further intensifying the competition for retail and commercial customers. New entrants are attracted by the reputation for transparency, firm Central Bank supervision and strong ties to the surging economies in the GCC and MENA regions.

Summary

2006 represented IIB's third full year of operations, and the Bank achieved further important milestones in its development. These include a very strong financial performance, several new investment transactions, highly profitable exits well ahead of plan, the recruitment of additional staff and the implementation of policies and procedures prepared in association with external consultants. I am confident that solid foundations have now been laid for the Bank to move to the next stage of its development, which will be given strong impetus by a material increase in our paid-up capital during the first half of 2007. This is a tangible demonstration of the excellent support that the Bank has always enjoyed from its shareholders, and it will enable IIB to scale up its operations in a prudent and sustainable manner.

During the course of 2006, IIB arranged five new investments and successfully exited two transactions. In keeping with the Bank's strategy, the new investments were diversified by asset type, by economic sector and by country. They included a commercial office tower in Dubai, a housing development company in Saudi Arabia and a portfolio of commercial properties in France.

Another important milestone was reached by the Bank during 2006 when we achieved the first exits from investments, being a prime office building in the West End of London and a commercial tower development in Dubai, in both cases delivering outstanding returns to our investors several years ahead of schedule. These two highly successful exits have helped to cement IIB's reputation both with investors and with institutional partners, and to establish a clear track record for the Bank in both the origination, structuring, management and delivery of profitable Shari'ah-compliant investments.

In keeping with best practice, corporate governance is being further enhanced through changes to the board and management committee structure. Details can be found at pages 10-11.

During the course of the year the Internal Auditor undertook several audits in accordance with the audit programme approved by the Audit Committee. The Bank also underwent a routine examination by the Central Bank of Bahrain which revealed no material regulatory concerns.

IIB, through our strong global network of contacts, continues to gain access to high quality investments. We subject each project to various stress tests, and benefit from the input of reputable external advisors to assess their viability.

Selecting the right deals and working with world class partners from within the region and internationally to maximize value is critical to the ongoing success of IIB. Real estate continues to be an attractive asset class and we are well placed to offer a broad and well balanced portfolio of properties, both from within this region and other strong performing markets. We seek out attractive assets that are diversified by country, sector and asset type, and we have thereby been able to provide our investors with a balanced portfolio, as well as superior risk-adjusted returns, during a period when regional stock markets have suffered sharp corrections. Rigorous due diligence and efficient execution provide the solid foundations on which all of IIB's investment decisions are based.

Investment Transactions

In 2004, its first full year of operation, IIB established a property fund based in Bahrain and purchased an equity investment in an independent power company in Asia. During 2005, the Bank successfully arranged and placed six investments. These comprised opportunities across a number of asset classes and geographic locations, including commercial real estate investments in the UK and Dubai, a strategic direct investment in an Islamic investment bank in Europe, a housing development company in Bahrain, a new paper mill plant in Abu Dhabi and placement of the equity investment in the independent power company in Asia set up in 2004. In 2006, the Bank arranged and placed five new investments and successfully exited from two investments that it arranged and placed in 2005. A summary of these seven transactions is as follows:

New Transactions in 2006

IIB UAE Investment Limited West Bay Tower

Total transaction size: US\$ 89.1 million

In April 2006, IIB took a 65% stake

in the proposed state-of-the-art West Bay Tower, which is being developed in partnership with SNASCO, a GCC-based real estate development company, and will form part of the Business Bay District in Dubai, UAE. The 30-storey X-shaped West Bay Tower provides 75,702 sq. metres of floor space and is due for completion in the fourth quarter of 2008. It offers investors the potential early realization of their investment through pre-sales of office units during the construction period of the Tower.

This is IIB's second investment in Dubai's Business Bay development, which is being planned by the Dubai Government as the new dynamic 'downtown' area of Dubai, the pre-eminent business hub in the UAE and the region. The projected Internal Rate of Return (IRR) on the West Bay Tower project is 21.6% over an investment horizon of 36 months and was heavily oversubscribed by investors from across the GCC in June 2006.

IIB KSA Investments Ewaan

Total transaction size: US\$ 106.7 million

In July 2006, IIB and its co-investors formed Ewaan, a real estate development company for investment in the Saudi Arabian real estate market. To be based in Saudi Arabia, and with an authorized capital of SR 400 million (US\$ 106 million), the company plans to invest SR2 billion (US\$ 533 million) in the fast-developing Saudi Arabian property sector over the next three years. The strategic partners include the Islamic Corporation for Development of the Private Sector (ICD), a multilateral investment affiliate of the Islamic Development Bank, and the Saudi Economic and Development Company (SEDCO), a Saudi-based investment group.

Included in Ewaan's strategic shareholder base is a well diversified mix of highly regarded investors, including high net worth individuals and financial institutions, multilateral businesses as well as government organisations.

Among these are the Saudi Arabian Pension Fund and the Alzahid Group.

Ewaan will explore a broad range of opportunities in the Saudi Arabian real estate market, in particular the mid-market housing segment, where demand far outstrips supply and into which little investment has been channeled to date. According to recent projections, it is expected that over the next ten years the gap between housing supply and demand in Saudi Arabia will reach some 1 million units. Ewaan believes the mid-market segment represents a large proportion of this requirement.

The IRR for investment in the company is expected to be in excess of 22% over a three to five year horizon. Further, there is scope for significantly enhanced returns through capital appreciation at exit should the company be floated through an Initial Public Offering (IPO).

IIB France Investment Holding B.S.C.

Total transaction size: US\$ 105.6 million

In December 2006, IIB acquired a high-quality portfolio of commercial real estate properties in France. IIB and its investors are taking a 90% stake in the portfolio, which comprises six commercial properties that are strategically located in France's two largest cities, Paris and Lyon. There is strong demand for office space in the French commercial property sector and particularly in these key commercial hubs.

In making the acquisition, IIB has partnered with a renowned asset manager with extensive experience in the structuring and management of Shari'ah-compliant real estate investments in Europe, and who holds the remaining 10% share ownership in the portfolio. The investment represents IIB's third European investment and its second real estate acquisition in Europe.



(FROM LEFT TO RIGHT) MR. MOHAMED HADI MEJAI, EXECUTIVE DIRECTOR, INVESTMENT AND BUSINESS DEVELOPMENT; MR. FREDERICK STONEHOUSE, EXECUTIVE DIRECTOR, BANKING SUPPORT; MR. AABED AL-ZEERA, CHIEF EXECUTIVE OFFICER; MR. SALAH NOORUDDIN, CHIEF OPERATING OFFICER; MR MICHAEL ROSS-MCCALL, CHIEF FINANCIAL OFFICER

The projected IRR on the investment is in the region of 12% over an investment horizon of five years, with cash yields ranging from 8.6% to 9.2% per annum.

British Islamic Insurance Holding Limited

Total transaction size: US\$ 33.0 million

The company is the first independent UK entity to provide insurance ("Takaful") products that are wholly Shari'ah compliant. IIB took a strategic investment of US\$ 1.9 million to increase its presence in the Shari'ah-compliant Takaful insurance sector, and to build a privileged relationship with the other founders for possible larger future investments.

Sabaak Leasing and Investment Company

Total transaction size: US\$ 51.7 million

The company is incorporated in Kuwait and provides operating and financial leases, as well as new and innovative products, all under Islamic principles. IIB took a small strategic investment of US\$ 0.4 million to increase its presence

(FROM LEFT TO RIGHT) NASSER ELDINE BAYOUN, PRINCIPAL, BUSINESS DEVELOPMENT;
HAKAN GUNAY, DIRECTOR, BUSINESS DEVELOPMENT; ASHWIN KUMAR, INVESTMENT ASSOCIATE; ATIF NAVEED, INVESTMENT ASSOCIATE; NADER AL-KHALILI, PRINCIPAL, BUSINESS DEVELOPMENT;



SALAH NOORUDDIN, CHIEF OPERATING OFFICER; AL IMRAN KHAN, INVESTMENT ASSOCIATE; MOHAMED HADI MEJAI, EXECUTIVE DIRECTOR, INVESTMENT AND BUSINESS DEVELOPMENT; FADI AL QASSIM, PROJECT MANAGER; BISHAYER AL-KHAJA, INVESTMENT ASSOCIATE



(FROM LEFT TO RIGHT) ALI REDHA, HEAD OF INTERNAL AUDIT; MICHAEL ROSS-MCCALL, CHIEF FINANCIAL OFFICER; SUSHIL JAIN, PRINCIPAL-RISK MANAGEMENT; NADER ASAD, DIRECTOR-FINANCE & ADMINISTRATION; HALEEMA EBRAHIM, ACCOUNTANT; HASSAN ABBAS, ACCOUNTANT



in the Sharia'ah compliant financial sector, to deepen its knowledge about the leasing sector and to fortify its presence in the corporate sector in Kuwait.

Exits in 2006

IIB Business Bay Properties Limited

One@Business Bay

Total transaction size in 2005:

US\$ 94.1 million

In November 2005, IIB acquired a 50% equity stake in One @ Business Bay, a 30-storey high-end office tower in the rapidly developing Business Bay district in Dubai, being developed in partnership with Dubai-based Omniyat Group. The Bank recognized that the spectacular growth in other UAE sectors would provide an attractive growth potential in the commercial real estate sector because of an imbalance in the supply / demand equation for prime offices in Dubai. The investment was successfully placed with IIB's investors in early 2006 with a target IRR of approximately 23%. Not only was it oversubscribed, but during the placement period all 30 office floors in the Tower were pre-sold at the target price.

In December 2006, IIB achieved a profitable early exit for its investors from the project, following the sale of their 50% equity stake to their joint-venture partners in the project. The sale achieved a highly attractive IRR of 25% only 11 months after the original investment was made, compared with the planned minimum investment holding period of 18 months. The combination of IIB's financial, structuring and placement capabilities with Omniyat's marketing and development expertise proved to be an extremely successful formula.

IIB Belgravia Property Company Limited

Total transaction size in 2005:

US\$ 300.7 million

In June 2005, IIB acquired a landmark commercial property occupying a prime site in the prestigious Belgravia area of London, in conjunction with SEDCO, a leading private Islamic investment company in Saudi Arabia. The property benefited from a long-term lease to the UK subsidiary of one of the world's leading energy companies. IIB placed the investment with its investors on the basis of a five year investment holding period, a cash dividend of 7.5% p.a. and an IRR in excess of 10%. The London commercial real estate market then strengthened and the Bank achieved an equity release in November 2006 of 55% of the original investment and an increased cash dividend to investors of 10% p.a. on both the original and the remaining equity.

The building was sold for US\$ 409 million in December 2006, achieving a total return of 98% in only 17 months, equivalent to an IRR of 67% for our investors. We not only far exceeded initial projections, but also delivered this exceptional result well in advance of the original five year investment holding period.

Outlook for 2007

The Bank enters 2007 with a strong investment pipeline developed in conjunction with its broad network of high-caliber financial institutions and technical partners from around the world. IIB expects to announce a number of compelling deals across multiple industry sectors and asset classes internationally in the months ahead. This will include further investment opportunities in real estate and private equity, but we will continue to be highly selective, targeting market segments and countries where there are still good growth prospects. We are confident that we will be able to continue delivering attractive risk-adjusted returns for our investors.



Information Technology

The Bank continued to invest in information technology systems in parallel with the growth in business activity and staff numbers. A committee is being formed to select and implement a state-of-the-art core banking system with the help of external consultants. It is anticipated that the new systems will be operational at the end of 2007 or early 2008 and will significantly enhance the Bank's operational efficiency, its capacity to process larger transactions, and its customer relationship management.

Human Resources

As the scale of the Bank's operations has grown, its organization structure has also evolved in order to maintain business momentum, and to ensure sound corporate governance and an effective control environment. The total head count increased from 20 to 40 at the end of 2006 and is expected to increase to around 60 by year end 2007 in order to handle the planned increase in business.

Experienced specialist staff have been recruited to key positions, including a Chief Financial Officer, a Director of Business Development, a Head of Legal & Compliance, a Head of Investor Services, an Engineer as Project Manager and a Head of I.T. During the first half of 2007 we expect to complete the senior management team with the appointment of a Head of Human Resources, an Executive Director of Private Equity and Corporate Finance, and an Executive Director of Investment Placement.

The recruitment process has been very challenging, as the competition for qualified staff remains very strong, both regionally and internationally. The retention of key staff is therefore also a major challenge, making it essential to have attractive remuneration structures in place. Specific initiatives were taken to ensure that compensation

and benefits remained in line with the market, including a bonus scheme linked to both corporate and individual performance.

Recognising that staff are a key asset of the Bank, it continued to significantly invest in staff welfare and the provision of all necessary training and development opportunities. Most employees attended courses in Bahrain and elsewhere during the year.

Capital Increase

Our current intention is to have a rights issue for existing shareholders and to invite, on a selective basis, certain strategic investors who have invested in our deals to enable them to share in the success of the Bank. This move is in response to strong demand from both current shareholders and other strategic investors who are keen to acquire an equity stake in IIB. Subject to regulatory and shareholder approvals, it is planned to increase the paid-up capital from US\$ 43 million to US\$ 100 million by mid 2007. With the associated share premium, this will expand the Bank's equity base to over US\$ 175 million. With increased capital resources at its disposal, IIB will be in an enhanced position to identify and arrange a number of more sizeable transactions across diverse industry sectors and countries.

Aabed Al-Zeera
Chief Executive Officer



One@Business Bay



Bahrain Property Fund



THE COMPANY PLANS TO INVEST SR2 BILLION (US\$ 533 MILLION) IN THE FAST-DEVELOPING SAUDI ARABIAN PROPERTY SECTOR OVER THE NEXT THREE YEARS

Diversified investments across many different sectors including energy

IIB KSA Investments Ewaan IIB Power Company Limited



THE BUILDING IN BELGRAVIA WAS SOLD FOR US\$ 409 MILLION IN DECEMBER 2006 ACHIEVING AN IRR OF 67% IN ONLY 17 MONTHS

Private equity finance of West Bay Tower aggregated to US\$ 25 million

IIB acquired a high quality portfolio of commercial real estate in France valued at US\$106 million

IIB Belgravia Property Company Limited

IIB UAE Investment Limited
West Bay Tower

IIB France Investment Holding BSC

During the year ended 31st December 2006, the Bank recorded net income of US\$ 13.5 million, compared to US\$ 7.0 million during 2005 - an increase of 92.2%. Total assets at year-end 2006 aggregated to US\$ 94.5 million, up 49.2% or US\$ 31.1 million as compared to year-end 2005. Net cash from operating activities was US\$ 40.5 million (2005: negative US\$ 1.1 million) and cash and cash equivalents were a healthy US\$ 62.7 million at the end of 2006.

The key financial ratios were strong and further improved in 2006. Return on average equity rose from 14.8% in 2005 to 24.0%, while return on average assets increased from 13.0% to 17.1%. Earnings per share improved from 16 cents to 31 cents.

Income

The Bank's total income increased by 98.1% during 2006 to US\$ 24.6 million. This was driven mainly by significantly higher investment fees which increased from US\$ 10.9 million in 2005 to US\$ 17.1 million, earned from the structuring, underwriting and placement of new investments. Exit income, representing performance fees earned by the Bank for exceeding pre-determined hurdle rates, aggregated to US\$ 4.3 million (2005: nil). This is a clear validation of the business model that IIB has put in place, which is founded principally on the generation of fee income from arranging and placing investments. The net gain on sale of investments in 2006 was US\$ 1.0 million (2005: nil). Income on due from financial institutions, being the profit on commodity murabaha and income on investment in mudaraba, was US\$ 1.8 million versus US\$ 1.0 million in 2005.

Expenses

Profit on due to financial institutions, representing payments made for funds received on the principles of murabaha contracts, totaled US\$ 0.3 million (2005: nil). Staff compensation and benefits of US\$ 7.4 million were significantly higher than in 2005, on account of the doubling of the headcount from 20 to 40 and the payment of higher bonuses linked to the higher total income and achievement of individual performance goals. General and administration expenses more than doubled to US\$ 2.1 million, being mainly travel, legal, professional fees, printing and advertising linked to the higher level of business activity. Depreciation increased by US\$ 0.2 million from the capital expenditure in 2005 on fitting out the new offices. Directors' remuneration of US\$ 0.15 million was expensed in 2006 in respect of 2005 services. The cost-to-income ratio increased in 2006 to 45.2% from 43.5% in 2005 but compares very favourably with regional and international investment banks.

Assets

Cash & balances with banks and due from financial institutions at year-end 2006 of US\$ 9.3 million and US\$ 53.5 million respectively were in aggregate 130% higher than a year earlier. The extra liquidity was provided from retained profit, lower net receivables and higher murabaha payables.

Investments increased by US\$ 2.7 million (20.0%) to US\$ 16.4 million, represented by the Bank's retention in investment deals offered to investors in 2006, less sales and part disposals during the year.

Resulting from the new investment offerings in 2006 less the two exits, assets under management increased by 54.5% from US\$ 117.6 million to US\$ 181.7 million.

Liabilities and equity

Due to financial institutions at the end of 2006 represented murabaha contracts payable (2005: nil). Equity increased by 20.9% to US\$ 61.4 million, mainly from the 2006 net income less the 2005 dividend of US\$ 3.4 million transferred to liabilities following the shareholders' approval.

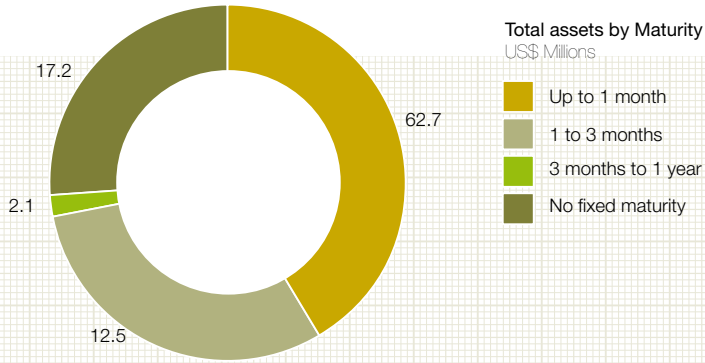
Capital adequacy

As compared to the minimum capital adequacy ratio of 12% prescribed by Central Bank of Bahrain (CBB), the Bank's ratio at year-end 2006 was 134% (2005: 101%). This ratio, reflecting credit and market risk, is based on guidelines issued by CBB which are compatible with those of the Basel Committee on Banking Supervision. The ratio measures total qualifying capital held by an institution in relation to its risk-weighted assets.

CBB has stated that all banks incorporated in Bahrain should adopt the Basel II rules commencing from 1 January 2008. Pending clarification of the rules by CBB, the Bank has not conducted a detailed impact study under Basel II. However, in the opinion of management, the adoption of Basel II is expected to leave its ratio well above the minimum required.

Total assets by Maturity Profile

US\$ Millions

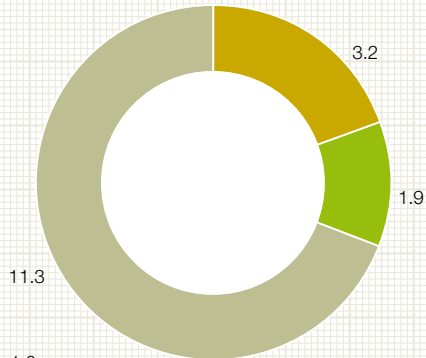


- Up to 1 month
- 1 to 3 months
- 3 months to 1 year
- No fixed maturity

Investment Type

US\$ Millions

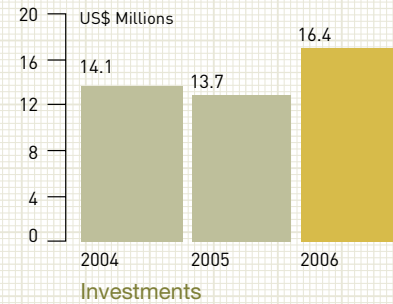
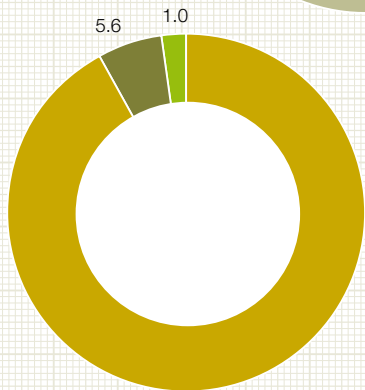
- Carried at Fair Value through Statement of Income
- Available for Sale
- Investment Property



Total Assets by Region

US\$ Millions

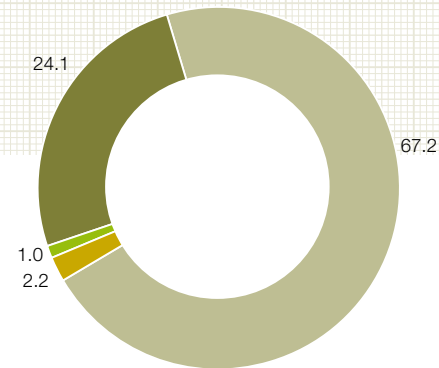
- Europe
- GCC
- Far East



Total Assets by Industry Sector

US\$ Millions

- Power Generation
- Real Estate
- Banking & Finance
- Others



The Board of Directors has overall responsibility for risk management. The Board approves and periodically reviews the risk policies and strategy of the Bank.

A Risk Management Committee (RMC) is being formed which will be responsible for submitting policy amendments to the Board and for ensuring the approved policies are implemented in accordance with the risk management procedures. The Risk Manager is responsible for identifying, measuring and managing the risks relating to the Bank's activities. Regular reports submitted to the Board enables it to ensure that risk levels are in fact within the policy limits set by it.

The efficient and timely management of risks involved in the Bank's business is critical to its financial soundness and profitability. The Risk Manager maintains standards to ensure:

- + Risks are well defined;
- + Quantitative assessments are widely used;
- + Control is active;
- + Measures are accurate; and
- + Management of risks is proactive and integrated.

The risk framework adopts the best industry practices in risk management to provide:

- + A risk focus which will enhance shareholder value through maximizing return on risk-adjusted capital; and
- + A framework that supports the current decision-making process and culture of strong internal controls in the Bank.

The Bank's risk management process encompasses various dimensions of risk, as follows. In addition, data in respect of the principle risks affecting IIB is shown at note 3 to the financial statements.

1. Market Risk

Market Risk is the risk to earnings resulting from adverse movements in foreign exchange rates, profit rate yield curves, equity prices and commodity prices for assets held in its portfolio. The size of Market Risk is not considered significant, as the Bank does not trade in investments or foreign exchange and does not have any derivatives.

To enable effective monitoring and managing of exposures, all Market Risks associated with the Bank's investments are properly measured. The following factors are taken into account when measuring the Market Risk in the Bank's investment portfolio:

- + **Volatility:** the extent of fluctuation in the value of the investment is an important factor in determining and measuring the extent of Market Risk embedded in it;
- + **Liquidity:** the availability of ready buyers or a market in which investments may be liquidated is equally essential to assess the Market Risk involved. In the absence of a liquid market, the investments may have to be sold at a 'distressed price';
- + **Concentration:** the diversification of the Bank's exposure across different countries and sectors and in different types of investments helps avoid concentration risk;
- + **Independent Source:** when valuing an asset, it is preferred to have an independent specialist source from which prices are obtained to enhance the credibility of the valuation; and
- + **Independent Valuation:** the individual or department responsible for valuing or marking-to-market the investments is independent of the individual or department responsible for the investment.

1.1 Investment Risk

Investment (or Equity Price) Risk is the risk of loss arising out of either deterioration in the market price of a marketable investment or the capital erosion of the Bank's investment in a business entity where the shares are not traded on any exchange.

The Bank does not have a trading portfolio at present and Investment Risk arises from various co-investments that IIB makes in the deals offered to investors. These investments are long-term and associated with private equity, real estate and asset management. The risks are controlled in the following manner:

- + **Business Plan and Risk Strategy:** each line of business will prepare its annual business plan to outline its risk capital requirements, targeted markets and the processes to address Investment Risk;
- + **Risk Review of New Deals:** The Risk Manager will review and evaluate risks associated with all new investment deals;
- + **Diversification of the Investment Portfolio:** to avoid concentration of investments in one particular country, industry or sector, the Bank follows exposure limits set by its Board of Directors, which are within the limits specified by the Central Bank of Bahrain;
- + **Investment Retention:** only a certain percentage of the total investment portfolio will be retained by the Bank;

- ✦ **Additional Investments:** all additional investments in transactions will be treated as new deals in the Bank's investment portfolio;
- ✦ **Limits and Limit Monitoring:** allocation of maximum limits available to each business for investment and the continuous monitoring of any breaches;
- ✦ **Valuation of Investments:** periodic valuation of all investments to current fair market value by Financial Control Department; and
- ✦ **Governance Over Existing Deals:** quarterly comparison of existing investment deals with pre-acquisition investment criteria.

1.2 Foreign Exchange Risk

Foreign Exchange Risk is the risk of loss arising from adverse movements in foreign exchange rates. In the ordinary course of business, a foreign exchange position will arise through investments in foreign countries and nostro balances.

The Bank faces Foreign Exchange Risk from the following exposures:

- ✦ **Transaction Exposure:** the risk that the domestic cost or proceeds of a transaction may change;
- ✦ **Translation Exposure:** the risk that the value of foreign-currency-denominated assets is affected by exchange rate movements; and
- ✦ **Economic Exposure:** the risk that exchange rate movements may affect the present value of future income streams.

The Bank manages Foreign Exchange Risk through the following process:

- ✦ **Net Open Positions:** developing net open positions in relation to foreign currency exposures based on the Bank's risk appetite; and
- ✦ **Limits and Limit Monitoring:** setting and maintaining limits on foreign currency net open positions.

IIB is pursuing suitable hedging strategies that are in accordance with Shari'ah principles.

1.3 Profit Rate Risk

Profit Rate Risk is the risk of a decrease in the Bank's net present value in the event of a variation in market reference rates. The net present value of the Bank is affected by an unfavourable movement of market reference rates when the Bank carries profit-bearing assets and liabilities on its balance sheet.

The primary source of Profit Rate Risk for IIB is the 'mismatch risk', which arises on account of differences in principal amounts, profit rates, maturity dates or re-pricing dates, in respect to its profit-bearing assets and liabilities.

The Bank employs the following techniques to manage Profit Rate Risk:

- ✦ **Profit Rate Risk Strategy:** to forecast and assess the risk sources;
- ✦ **Measurement of Profit Rate Risk:** to classify the Bank's profit rate sensitive assets and liabilities into time buckets to determine the Bank's risk exposure; and
- ✦ **Profit Rate Gap Analysis:** the development, implementation and monitoring of gap limits to manage the Bank's exposure against changing profit rates.

2. Credit Risk

Credit Risk is the risk to earnings or capital from the potential that a loss will be incurred if a counterparty fails to perform on a financial obligation as it falls due. It takes into account the probability of involuntary default, where the counterparty does not possess the financial means to repay and strategic default, where a counterparty with the ability to repay deliberately defaults.

The Bank manages Credit Risk through the following process:

- ✦ **Credit Risk Scoring and Grading:** development of a counterparty risk grading model to assess potential clients prior to undertaking exposures.
- ✦ **Developing Counterparty, Country and Sector Limits:** setting of maximum counterparty exposure limits based on the counterparty risk grading.
- ✦ **Monitoring Credit Exposure:** ongoing review of exposure limits assigned to each counterparty and continuous monitoring to avoid limit breaches.

3. Liquidity Risk

Liquidity Risk is the risk that the Bank may not be able to meet its obligations or commitments with regard to financing or the repayment of maturing debts. IIB has access to geographically diversified funding sources and manages its assets with liquidity in mind, including the maintenance of healthy balances of cash and cash equivalents. The Bank groups all assets and liabilities into specific maturity time buckets and monitors the mismatches between the inflows and outflows against approved limits.

The Bank uses a combination of the following techniques to manage Liquidity Risk:

- ✦ Funding Strategy - any projected liquidity shortfalls are highlighted in the mismatch report and appropriate remedial action is taken.
- ✦ Liquidity Gap Limits - mismatch limits are regularly reviewed and updated to reflect IIB's business requirements and risk appetite.
- ✦ Liquidity Contingency Plan - the Bank's liquidity profile is evaluated under different market conditions and any adverse liquidity scenarios are addressed.

4. Operational Risk

Operational Risk is the risk of direct or indirect loss resulting from breaches in internal controls, processing errors, inadequate information systems, fraud, or external events. Its impact can be in the form of a financial loss, loss of reputation or loss of competitive position. The Bank minimises its exposure by ensuring that appropriate infrastructure, controls, systems and trained, competent people are in place. In particular:

- ✦ Internal Audit Department issues regular reports including an annual organization-wide risk assessment;
- ✦ External auditors make recommendations on internal controls and processes;
- ✦ Business units are responsible for managing the operational risks relevant to their activities; and
- ✦ A well-established disaster recovery program exists covering computer backup, data recovery and premises continuity.

5. Legal Risk

Legal Risk is the risk arising from the potential that unenforceable contracts, lawsuits, or adverse judgements can disrupt or otherwise negatively affect the operations of the Bank. IIB has sought to mitigate its exposure to Legal Risk by establishing a Legal and Compliance Department headed by a qualified and experienced lawyer. In addition, it has relationships with well-established local and international law firms.

(FROM LEFT TO RIGHT) SABA AL-KHALIFA,
PRINCIPAL-INVESTOR RELATIONS;
MURTAZA GHULAM, PRINCIPAL-BANKING
SUPPORT; HASSAN ABU HASSAN,
ENGINEERING SERVICES HEAD;



FREDERICK STONEHOUSE, EXECUTIVE
DIRECTOR, BANKING SUPPORT;
MAZAR JALAL, PRINCIPAL-BANKING
SUPPORT

(FROM LEFT TO RIGHT) INVESTMENT
PLACEMENT TEAM MEMBERS: HASHIM JANAH,
FAWZAN AL-NASER, ALYAS ALMEFTAH, BADER
ALI, SAUDI AL YAHYA, ABDUL JABBAR AL-
KOOHEJI, RAYAN KAZEROONI,



EBRAHIM ALSHAIBEH, BASHAR AL-SHAIKH,
JASSIM AL SHAIKH WITH SALAH NOORUDDIN,
CHIEF OPERATING OFFICER (CENTRE).

**Shari'ah Supervisory Board
Report to the Shareholders of
International Investment Bank
B.S.C. (c)**

**Asslam Alaikum Wa Rahmat Allah
Wa Barakatuh**

**In compliance with the terms of our
letter of appointment, we are required
to report as follows:**

We have reviewed the principles and contracts relating to the transactions conducted by International Investment Bank B.S.C. (c) (the "Bank") during the course of the year ended December 31, 2006. Our review was conducted in order to judge whether the Bank followed the principles of the Islamic Shari'ah, specific fatwas, and guidelines issued by the Shari'ah Supervisory Board. The Bank's management is responsible for ensuring that its operations are carried out in compliance with our rulings. It is our responsibility to present an independent view of the Bank's operations and to communicate it to the shareholders.

Our review included a detailed analysis of each type of transaction with its relevant documentation and procedures adopted by the Bank.

The review was planned and performed so as to obtain all necessary information and explanations to provide sufficient evidence proving that the Bank has not violated any rules and principles of the Islamic Shari'ah.

In our opinion:

- The Bank's contracts, transactions and deals for the year ending December 31, 2006 are in compliance with the rules and principles of the Islamic Shari'ah.
- The Bank's allocation of profit and charging of losses relating to investment accounts are in compliance with the rules and principles of the Islamic Shari'ah.
- Earnings that have been realized from sources that are non-Shari'ah compliant were donated to charity.
- The Bank's calculation of Zakat is in compliance with the rules and principles of the Islamic Shari'ah.

We beseech the Almighty to grant us excellence and success.

Wassalam Alaikum Wa Rahmat Allah
Wa Barakatuh

Sheikh Nizam Yaquby

Chairman of the Shari'ah Supervisory
Board

28 Muharram 1428

15 February 2007



Independent Auditors' Report to the Shareholders of International Investment Bank B.S.C. (c)

We have audited the accompanying financial statements of International Investment Bank B.S.C (c) (the 'Bank') which comprise the balance sheet as at 31 December 2006 and the statement of income, statement of cash flows and statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Board of Directors' Responsibility for the Financial Statements

The Board of Directors is responsible for the preparation and fair presentation of these financial statements in accordance with both the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions to operate in accordance with Islamic Shari'ah and International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal controls 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. In addition the Board of Directors is responsible for the Bank's undertaking to operate in accordance with Islamic Shari'ah Rules and Principles.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with both the International Standards on Auditing and Auditing Standards for Islamic Financial Institutions. Those standards require that we comply with the relevant 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 auditors' 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 controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate for 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 the Board of Directors, 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.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2006 and of its financial performance and its cash flows for

the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Islamic Shari'ah Rules and Principles as determined by Shari'ah Supervisory Board of the Bank.

In addition, in our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2006 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Regulatory Matters

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the financial statements, and the contents of the Report of the Board of Directors relating to these financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank have occurred during the year ended 31 December 2006 that might have had a material adverse effect on the business of the Bank or on its financial position and that the Bank has complied with the terms of its banking licence.

15 February 2007
Manama
Kingdom of Bahrain