2007 Annual Report

بنك استثماري
Investment Bank
sico

Performance
Strategic Focus
Partnership

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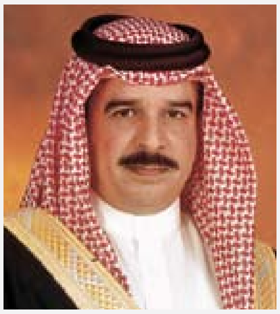
www.sicobahrain.com

Designed and produced by Gulf Marcom

HIS HIGHNESS
SHAIKH KHALIFA BIN
SALMAN AL KHALIFA

The Prime Minister of the
Kingdom of Bahrain



HIS MAJESTY
KING HAMAD BIN ISA
AL KHALIFA

The King of the
Kingdom of Bahrain

HIS HIGHNESS
SHAIKH SALMAN BIN
HAMAD AL KHALIFA

The Crown Prince and
Deputy Supreme Commander

SICO Mission Statement and Corporate Profile

SICO MISSION

To emerge as a leading securities house offering a selective range of investment banking services - including asset management, corporate finance and brokerage - throughout the GCC region. We aim to continuously provide innovative products and services, catering to the growing investment needs of our clients, while abiding to high ethical and professional standards of conduct. In so doing we aim to maximise shareholders' value as well as contribute towards strengthening Bahrain's position as a regional capital markets centre.

SICO PROFILE

As a leading Bahrain-based financial institution, Securities & Investment Company (SICO) provides clients across the GCC region with a selective range of investment banking services. These comprise asset management, brokerage, market-making, corporate finance, and custody and administration, which are underpinned by an independent, value-added research capability.

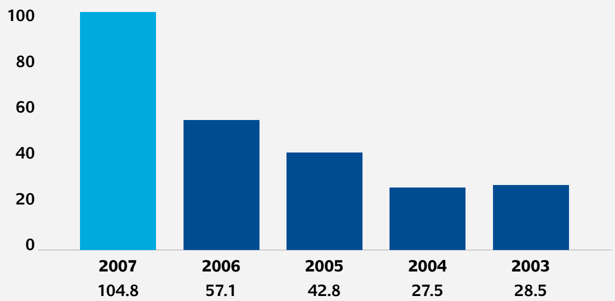
Commencing operations in 1995, SICO obtained an investment banking licence from the Central Bank of Bahrain (CBB) in 1997, and was listed on the Bahrain Stock Exchange in 2003 as a closed company. The Firm has four wholly-owned subsidiaries: SICO Funds Companies I, II and III, which are authorised by the CBB to carry out the business of collective investment schemes; and SICO Fund Services Company, which is a specialised regional custody house.

The core shareholders of SICO are major GCC financial institutions. They include two Bahrain government-owned pension funds, and several prominent regional investment, merchant and commercial banks.

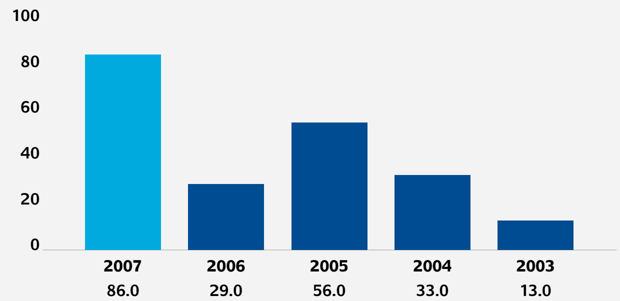
SICO is the largest broker and major market maker on the Bahrain Stock Exchange. The Firm's four equity funds have consistently outperformed indices and generated stellar returns in 2007. SICO is also a leading provider of corporate finance services, having successfully concluded a number of high profile IPOs, private placements, and bond and rights issues.

Financial Highlights

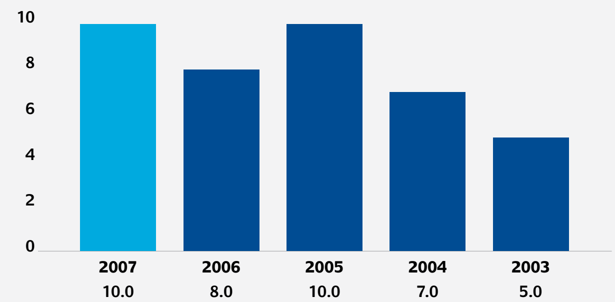
TOTAL ASSETS
BD Millions



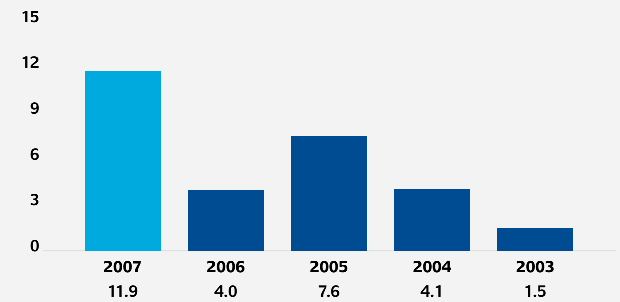
EARNINGS PER SHARE
Fils



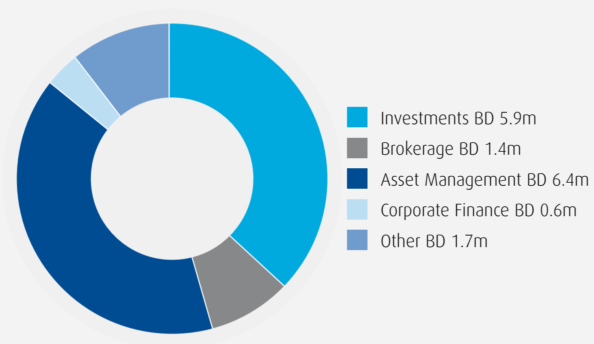
DIVIDENDS PER SHARE
Fils



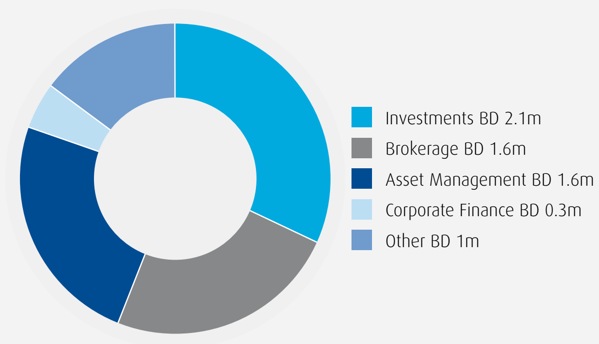
PROFIT
BD Millions



TOTAL REVENUE 2007
BD Millions
Year ended 31 December 2007



TOTAL REVENUE 2006
BD Millions
Year ended 31 December 2006



Chairman's Statement

Shaikh Mohammed bin Isa Al Khalifa

On behalf of the Board of Directors, it is my pleasure to present the annual report and consolidated financial statements of Securities & Investment Company (SICO) for the year ended 31 December 2007. I am delighted to report that this proved to be the most successful year ever for the Firm since commencing operations in 1995. Record financial results and sound strategic progress were supported by significant business achievements and ongoing organisational developments.

Financial Results

As the key highlights illustrate, SICO achieved a record financial performance in 2007. Total revenues grew by 143 per cent to BD 15.981 million, compared to BD 6.579 million the previous year, while net income increased by 194 per cent to BD 11.906 million (2006: BD 4.045 million). Earnings per share rose by almost 200 per cent to 86 fils (2006: 29 fils) reflecting our improved earnings, yielding an average return on equity of 33.6%, and a return on assets of 11 per cent. Assets under management grew 74 per cent to reach BD 230 million (2006: BD 132 million).

Economic and Market Background

These exceptional results were achieved against a background of robust growth by the GCC economies, and the recovery of the regional stock markets. The regional economy continued to benefit from high oil prices and enhanced liquidity levels, with all GCC states recording current account surpluses. As a result, public spending in major infrastructure and industrial projects was further increased, accompanied by, greater involvement of the private sector.

Following the severe correction witnessed the previous year, stock markets recovered during 2007, aided by strong economic drivers and business fundamentals, and renewed investor confidence.

Developments in the international markets during the year raised concerns about their potential impact on the region. These include the U.S. sub prime mortgage crisis and the global liquidity crunch, a weakening US dollar, and rising inflation due to the increase in the food costs and commodities. On a more positive note, the global economy continued to expand in 2007, albeit at a slower growth rate, with emerging economies again taking the lead.

Business Achievements

All revenue generating streams reported strong year-on-year growth, with increased contributions to the Firm's profitability in 2007. From a business point of view, SICO continued the positive trend of recent years. The Firm retained its position as the leading market maker and broker-of-choice on the Bahrain Stock Exchange, secured a number of important new mandates, launched a new equity fund, and increased assets under management by a significant margin. In addition, SICO continued to expand its geographic presence and broaden its range of products and services.

Strategic Progress

Our financial results and business achievements confirm that the Firm's overall strategy is working: to focus on serving the GCC region, grow and diversify our business, pursue a client-oriented business model, and maintain a disciplined approach to managing our expenses, risk and capital.

A key strategic development during the year was the provisional approval from the Central Bank of Bahrain for SICO to change its license to a wholesale bank in 2008. The resulting enhanced regulatory status and increased paid up capital will herald a new chapter in the history of the Firm. As a wholesale bank, we will be able to introduce new products and services, handle larger transactions, and substantially expand the business.

The Firm's excellent progress during 2007 would not have been possible without the trust and partnership of our clients; the commitment, dedication and integrity of our people; and the longstanding support of our shareholders.

Corporate Responsibility

Throughout the year, we continued to build the Firm's institutional capability: enhancing our corporate governance and risk management framework; maintaining our focus on expense discipline; and continuing to broaden the balance sheet. In addition, we recruited additional professionals to support our business growth; expanded our research capabilities; and initiated a major revamp of our IT systems. We also continued the Firm's social responsibility programme by supporting a variety of charitable, medical, educational, cultural and community organisations and other deserving causes.

Appropriations

Based on the Firm's 2007 financial results, the Board recommends the following appropriations for approval by the shareholders:

1. Transfer of BD 1.191 million to the General Reserve.
2. Payment of a cash dividend of BD 1.392 million to shareholders, representing 10 per cent of paid-up capital.
3. Directors' remuneration of BD 200 thousand.
4. BD 50 thousand to be spent on charitable, cultural and educational activities.

After appropriations, total shareholders' equity will be BD 40.5 million compared to BD 27.4 million in 2006.

Acknowledgements

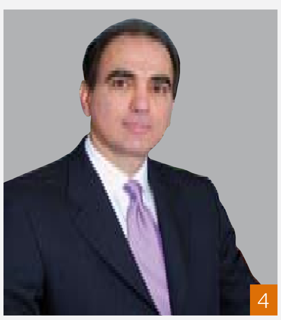
During 2007, Mr. Abbas Ameeri, representing Gulf International Bank, was replaced by Mr. Ali Rahimi on the Board of Directors. I would like take this opportunity to thank Mr. Ameeri for his sterling contribution to the growth and development of SICO during his tenure of office, and to welcome Mr. Rahimi, whose diverse international banking experience will prove to be of valuable benefit to the Board.

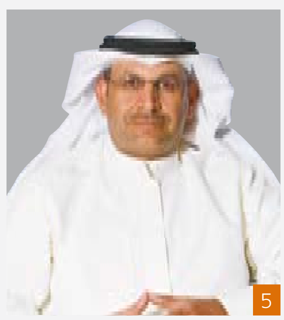
The Firm's excellent progress during 2007 would not have been possible without the trust and partnership of our clients; the commitment, dedication and integrity of our people; and the longstanding support of our shareholders. On behalf of the Directors, I would like to take this opportunity to thank you all for contributing to another successful year for SICO.

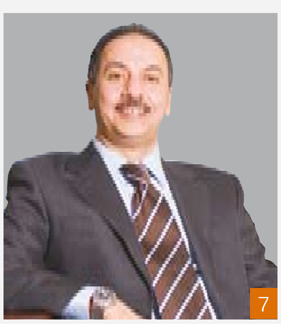
As a final point, and on behalf of the shareholders, my fellow Board members and management, I would like to express my appreciation to His Majesty the King, His Highness the Prime Minister, and His Highness the Crown Prince, for their wise leadership and support of the Kingdom's financial sector. I would also like to thank the Ministry of Finance, the Ministry of Industry and Commerce, the Central Bank of Bahrain, and the Bahrain Stock Exchange for their continued guidance and support.

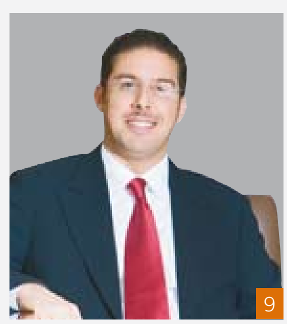
Shaikh Mohammed bin Isa Al Khalifa
Chairman of the Board

Board of Directors & Management Team









BOARD OF DIRECTORS

1. Shaikh Mohammed bin Isa Al Khalifa
Chairman
Represents General Organisation for Social Insurance

2. Albert I. Kittaneh
Vice Chairman, Chairman of the Executive Committee
Represents BMB Investment Bank and other Shareholders

3. Hussain Al Hussaini
Director, Vice Chairman of the Executive Committee
Represents National Bank of Baharin

4. Ali Rahimi
Director, Member of the Executive Committee
Represents Gulf International Bank

5. Abdulaziz I. Al-Mulla
Director, Member of the Executive Committee
Represents Gulf Investment Corporation

6. Anwar Abdulla Ghuloom
Director, Chairman of the Audit Committee
Represents Pension Fund Commission

7. Mahmoud Al Zewam
Director, Member of the Audit Committee
Represents Arab Banking Corporation

8. Abdul Karim Bucheery
Director, Member of the Audit Committee
Represents Bank of Bahrain and Kuwait

9. Khalid Al Rumaihi
Director
Represents Investcorp

MANAGEMENT TEAM

Anthony C. Mallis
Chief Executive Officer

Najla Al Shirawi
Chief Operating Officer & Treasurer

Hanan Y. Sater
Financial Controller

Nadia Khalil
HR & Administration

Shakeel Sarwar
Asset Management

Fadhel Makhlouq
Brokerage

Ramy Echo
Corporate Finance

Omran Ahmed
Marketing

T. Rajagopalan
Risk Management

Ismail Sabbagh
Information Technology

David Halstead
Operations

Zain Al-Zayani
Corporate Communications

Jithesh Gopi
Research

A. R. Srinivasan
Internal Audit

Anthony C. Mallis

Management Review of Operations

INTRODUCTION

Taking full advantage of the continued regional economic boom and recovery of the GCC stock markets during the year, SICO achieved a remarkable performance, both in terms of financial results and business achievements. Our record financial results reinforce the Firm's policy to diversify revenue streams and achieve an optimum balance between fee-based revenue and proprietary income. In addition, the Firm's strategy to focus its business activities on the GCC has continued to pay dividends in terms of improved revenues, increased transactions, and an expanded client base. Based on our achievements to date, the future outlook is encouraging. The change in SICO's status to a wholesale bank in 2008, supported by a strong pipeline of business and an enhanced institutional capability, will enable us to expand our activities and continue to grow our revenue streams and profitability.

As we predicted, the GCC markets recovered from the major correction experienced in 2006, and showed a marked improvement in 2007. This was supported by the growth momentum of the GCC economies, continued strong business fundamentals, and renewed investor confidence. Based on the previous year's experience, markets have begun to initiate reforms to ensure greater transparency and discipline, with recent IPOs showing signs of more professional valuation and pricing, which we view as an encouraging sign of maturity. What is required next is for a deepening of GCC capital markets through a more robust and realistic regulatory framework, more capital market issues, the introduction of hedging instruments, and the development of a debt market and not ignoring the "Inflationary" clouds that are appearing on the regional economic horizon.

Financial Overview

All revenue generating streams improved their performance and produced excellent results in 2007. The overall results confirm that we have achieved an improved balance between our business lines, with proprietary activities generating 37 per cent of our revenues, while our annuity streams contributed 41 per cent, with interest and other income accounting for 22 per cent of revenues. Balanced and diversified revenue generators will enable the firm to accommodate any future GCC market volatility.

Expenses increased during the year due to adjusting employees' compensation in line with market levels. Expenses as a percentage of total income decreased from 38 per cent to 25 per cent, with staff cost as a percentage of total expense increasing to 77 per cent from 70 per cent. Staff cost as a percentage of total income decreased to 20 per cent from 27 per cent. Balance sheet ratios improved during the year, with greater liquidity and less leverage.

SICO remains well capitalised and soundly financed. Shareholders' equity, before proposed appropriations, was BD 42 million compared to BD 28 million in the previous year. At the year-end, shareholders' equity as a percentage of total assets was 40 per cent, compared with 50 per cent at the end of 2006. The Firm's capital adequacy ratio as of the balance sheet date was 35.5 per cent compared to 37.4 per cent the previous year.

OPERATIONAL ACHIEVEMENTS

Investments and Treasury

During 2007, SICO maintained its position as the leading market maker on the Bahrain Stock Exchange since 1997, and also consolidated its position as one of the region's premier market makers. As a result of growing interest from clients, especially outside Bahrain, the Firm added new mandates and extended its geographic reach during the year. This included making a market for its own book for Global Depository Receipts (GDRs) of two Bahrain financial institutions on the London Stock Exchange.

SICO's proprietary business performed well in 2007. With the GCC markets in recovery mode, profit on trading securities amounted to BD 4.3 million compared to BD 50 thousand loss the previous year. At the same time, profit on the sale of securities available-for-sale decreased to BD 952 thousand compared to BD 1.6 million in 2006. Concurrent to this, dividend income increased by 16 per cent to BD 693 thousand, compared to BD 593 thousand in 2006. Outside the region, the SICO's conservative and well-diversified investments in hedge funds and commodities produced strong returns.

The Firm's Treasury business enjoyed an excellent year in 2007, despite the challenging interest rate environment. Clients' deposits, cash management and currency exchange contributed significantly to the robust growth in interest and forex income. Interest income from margin trading accounts and OD accounts also grew during the year.

Performance through partnership:
Developing a benchmark for successful privatisation in the GCC.

SICO's role as lead manager, lead underwriter and financial adviser for the highly successful privatisation of Seef Properties by the Government of Bahrain in May 2007, serves to illustrate the Firm's value proposition of partnering with its clients to fully understand their needs and help them achieve their objectives.

The primary objective of the Government of the Kingdom of Bahrain was to give preference to Bahraini citizens and help create a new class of capital owners in the Kingdom. In response, SICO developed a pioneering IPO structure that introduced a number of innovative features, including two separate retail and institutional offerings. The retail offering was for Bahraini individuals subscribing for 5,000 to 50,000 shares, with the upper and lower subscription limits providing a shelter from oversubscription. While the two offerings were equally divided, they included a claw-back mechanism of up to 15 per cent favouring the retail offering which, in case of oversubscription, could increase up to 65 per cent, with the institutional offering decreasing to 35 per cent.

Another mechanism to ensure maximum allocation of shares to subscribers was an over-allotment or 'green shoe' option, allowing the total size of the offering to be increased from 179.4 million to 222.9 million shares in the event of oversubscription. With the objective of bringing value to subscribers, Seef shares were offered at the price of BD 0.125. However, retail investors benefited from an additional price incentive of 15 fils discount per share, together with an installment plan allowing 50 per cent payment upon subscription and the remaining 50 per cent payment at the end of the year on an interest-free basis. These incentives led to the IPO being oversubscribed 3.5 times. However, due to the structure that favoured the retail offering, Bahraini individuals were allocated 100 per cent of their subscriptions.

Since being listed on the Bahrain Stock Exchange (BSE) on 29 July 2007, shares of Seef Properties have outperformed all other previous IPO listings in the Kingdom. By the end of the year, the stock was up 58.4 per cent compared to an increase of 10.1 per cent in the BSE Index and a decrease of 0.3 per cent in the Bahrain Service Sector Index. The shares have also created substantial value for investors – 80 per cent for Bahraini individuals and 58 per cent for institutions.

SICO worked closely with the Ministry of Finance, Economic Development Board, and Seef Properties to ensure that the IPO was conducted 'by the book' in line with the highest standards of transparency and professionalism. As well as thorough and detailed legal and financial due diligence, two separate asset valuations, using different approaches, were carried out to ensure a fair valuation and pricing. A call centre was set up to deal with questions from the general public, while a media campaign was mounted to educate the public about the inherent risks and benefits of such an investment.

The success of the IPO has set a new template for privatisation in Bahrain and the region as a whole. Many of the innovative aspects of the offering structure have been adopted by subsequent IPOs in other GCC states.

During 2007, SICO maintained its position as the **leading market maker** on the Bahrain Stock Exchange since 1997, and also consolidated its position as one of the **region's premier** market makers.

Brokerage

Net income from brokerage activities decreased by 10 per cent to BD 1.4 million in 2007 compared to BD 1.6 million the previous year, with SICO's position as the leading broker on the Bahrain Stock Exchange (BSE) was sustained for the ninth consecutive year. The Firm's market share by value of all trades on the BSE amounted to 48.7 per cent (2006: 71.3 per cent), while the overall value of transactions amounted to BD 392 million for the year (2006 : BD 745 million).

In a unique tender-offer transaction, SICO represented Dubai Financial Group as its buy-side broker in the acquisition of a 60 per cent stake in Bahrain-based Taib Bank. The total acquisition transaction value was BD 61.1 million.

Also during the year, SICO increased its business with non-Bahraini clients, further enhancing its status as the 'broker of choice' on the BSE for international fund managers, prime brokers and banks. Over 50 per cent of the BSE's turnover is generated by foreign investors, with the majority of trading being executed by the Firm.

SICO's pan-Gulf capabilities continued to complement the Firm's Bahrain-based brokerage activities. During 2007, an upgrade in coverage and service levels contributed to a substantial increase in cross-border activity on behalf of institutional and individual clients in GCC markets.

Asset Management

The Firm's asset management business performed remarkably well in 2007. Assets under management increased to BD 230 million, due largely to the winning of new mandates from regional financial institutions, and the launch of an additional investment fund. Accordingly, management fees rose by 10 per cent, while increased revenues generated significantly higher performance management fees.

The first of its kind, the SICO Arab Financial Fund was launched in August. The primary objective of this open-end fund is to seek long-term capital appreciation by investing in financial sector equities listed on Arab stock markets. The Fund has performed well since its launch, with returns in excess of 20.7 per cent by year-end.

SICO's other existing equity funds – Khaleej Equity Fund, SICO Gulf Equity Fund, and SICO Selected Securities Fund – all performed strongly during 2007, outperforming their respective benchmarks by margins ranging from 31 per cent to 44 per cent. This strong performance continues to be attributable to the Firm's conservative asset allocation and bottom-up driven stock picking strategy. Portfolio managers focus on identifying companies that are fundamentally strong and that are trading at less than their fair values.

The success of this approach was endorsed during the year by Standard & Poor's (S&P) issuing an 'A' rating for the Khaleej Equity Fund. In its report, S&P cited the quality of the Fund's management team and the sophistication of its approach, as key reasons for the high rating. Given that only around 20 per cent of all international funds are rated 'A' and above, this is a significant achievement for the Firm.

Investment Banking

The Firm's corporate finance and equity-debt origination business enjoyed another successful year in 2007. SICO was involved in several IPOs, private placements, and rights issues; and also provided specialist advisory services for a growing number of regional and international clients.

SICO acted as lead manager, lead underwriter and financial adviser for the successful privatisation of Seef Properties by the Government of Bahrain in July 2007. The Firm adopted a pioneering IPO structure that included a special retail offering to protect small investors, featuring a claw-back mechanism and over-allotment (green shoe) option in the case of oversubscription. This structure enabled retail investors to receive 100 per cent of their subscriptions, even though the IPO was oversubscribed 3.5 times. Retail investors also benefited from an additional price incentive of 15 fils discount per share, and an instalment plan allowing 50 per cent payment upon subscription and the remaining 50 per cent payment at the end of the year on an interest-free basis. Since being listed on the Bahrain Stock Exchange, shares of Seef Properties have outperformed all other IPO listings in the Kingdom, and set a successful template

SICO was involved in several IPOs, private placements, and rights issues; and also provided specialist advisory services for a growing number of regional and international clients.

for privatisation in the region. In addition, many of the innovative aspects of the offering structure have been adopted by subsequent IPOs in other GCC states.

Other key achievements include SICO's role as issue manager for rights issues for Bahrain Islamic Bank (BIsB) and Bank of Bahrain and Kuwait (BBK). The BD 85 million rights issue for BIsB, which was 10 per cent oversubscribed, enabled the bank to double its capital. The BD 50 million rights issue for BBK, which was a dual offering in Bahrain and Kuwait, was 5 per cent oversubscribed, and led to a 15 per cent increase in the bank's capital.

Also during the year, SICO acted as lead financial adviser and placement coordinator for a capital increase by Kalaam – a telecommunications company in Bahrain – to provide funding for the introduction of new Wi-Fi services; and as the sole Bahrain placement agent for the private placement element of the oversubscribed dual-tranche IPO of Ghabbour Auto in Egypt, which also featured a public offer to retail investors.

New mandates secured by SICO during 2007 include listing manager for the proposed cross-listing of Khaleeji Commercial Bank in Bahrain and Kuwait; and financial adviser and international placement agent for a Shari'ah-compliant private equity TMT fund investing in the MENA region.

In another key development, which reflects the growing strength and scope of SICO's activities on a regional basis, the Firm won approval as a Listing Sponsor on the DIFX. This licence will enable SICO to provide advisory services to those companies which are interested in listing on the DIFX.

Research

During the year, SICO enhanced its research capabilities in line with its commitment to offer clients a superior platform and level of service. The Firm's comprehensive research database was expanded, and now covers over 90 per cent of listed companies in the GCC, whose movements are constantly tracked. Company Research Reports were published on MTC/Zain, STC, Mobily, and Bank Muscat, together with a series of Strategy Notes covering areas such as GCC markets, investment trends, interesting sectors, and specific stocks.

SICO research activities also include acting as the Official Research Partner to the Oxford Business Group for their annual Emerging Bahrain publication; and contributing data for the Quarterly Updates on Capital Markets issued by the Central Bank of Bahrain.

Custody and Fund Administration

Through its wholly-owned subsidiary, SICO Funds Service Company (SFS), the Firm provides a pioneering range of custody and fund administration services to regional clients. SFS enjoyed its most successful year to date during 2007, during which the Company expanded its client base, posted a 60 per cent increase in net income, and substantially grew Funds under Custody.

Human Resources

SICO's unique corporate culture is a major factor in the Firm's continued success. An entrepreneurial but self-disciplined style of operating, that gets things done faster without excessive bureaucracy and red tape, helps to set it apart from other investment banks and financial institutions. Attracting and retaining the right kind of people who fit this mould is therefore of the highest strategic importance. In 2007, SICO successfully recruited additional experienced professionals to support the Firm's current and future business plans and strategic direction. In addition, the Firm continued to make a substantial investment in training and development, providing staff with every opportunity to gain new qualifications, enhance their knowledge and skills, and realise their full potential.

Information Technology

Utilisation of the latest information and communications technology (ICT) is a critical business enabler for SICO. During the year, the Firm established a new IT Development Committee as the principal policy-making body responsible for the planning, implementation and future development of ICT within SICO. Following a comprehensive review of the Firm's ICT capability requirements, the Committee identified a shortlist of potential suppliers for the implementation of a new state-of-the-art core banking system in 2008.

Outlook

The excellent results achieved in 2007 underline the continued success of SICO's consistent strategy and robust business model. As a result, the Firm is strongly positioned to take full advantage of the new business opportunities afforded by the growth momentum of the GCC economy, and to cater for the future development of the GCC markets. SICO enters 2008 with a strong pipeline of business and enhanced operational efficiency, better equipped to face the challenges ahead. These factors underpin Management's expectations of continued growth and improved profitability.

The decision taken at the 28th GCC Summit to launch a Pan-Gulf Common Market in 2008 is an encouraging development, especially for the region's stock markets, which will have a crucial role to play in its successful implementation.

It is therefore more important than ever to identify and agree solutions to the existing, and new, challenges that face the continued growth and maturity of GCC capital markets. The existing challenges have not changed: improving investor education, adopting greater transparency and regulatory control, deepening sophistication, and encouraging greater interconnectivity between markets.

A major new challenge is the growing trend of GCC states in establishing their own , and in most cases, competitive financial centres, resulting in creating barriers to regional players from operating seamlessly across these markets. This highlights the need for more harmonisation of capital market regulatory controls across the GCC, and a greater spirit of cooperation in working together to integrate regional stock markets, along the lines of more advanced economies.

Anthony C. Mallis
Chief Executive Officer

A

In 2007, SICO's flagship fund, Khaleej Equity Fund, was awarded an "A" rating by Standard & Poor. The rating reflects the appropriateness of the Fund's investment policy and the sustainability of its performance.

SICO Selected Securities Fund

Launch date: May 1998
Principal investment focus: Equity and debt securities listed, or expected to be listed, on the Bahrain Stock Exchange (BSE)
Fund return 2007: 31.4 per cent.
Benchmark return 2007: BSE All Share Index – 24.2 per cent
Fund return since launch: 211.9 per cent vs. benchmark 118.2 per cent

SICO Gulf Equity Fund

Launch date: March 2006
Principal investment focus: Equity securities listed on stock markets of GCC countries, excluding Saudi Arabia
Fund return 2007: 37.2 per cent
Benchmark return 2007: MSCI GCC ex-Saudi Index – 35.4 per cent
Fund return since launch: 27.4 per cent vs. benchmark 9.9 per cent

Khaleej Equity Fund

Launch date: March 2004
Principal investment focus: Equity securities listed on stock markets of GCC countries
Fund return 2007: 43.9 per cent
Benchmark return 2007: MSCI GCC Index – 44.1 per cent
Fund return since launch: 146.6 per cent (vs. benchmark – not available*)
Note: * Benchmark introduced in June 2005.

SICO Arab Financial Fund

Launch date: August 2007
Principal investment focus: Financial sector equities listed on Arab stock markets in Bahrain, Egypt, Jordan, Kuwait, Lebanon, Morocco, Oman, Qatar, Saudi Arabia, Tunisia, and the UAE.
Fund return 2007 (since inception): 20.7 per cent.

The strong performance to date by SICO's equity funds is attributable to the Firm's conservative asset allocation and bottom-up driven stock picking strategy, to achieve long-term capital appreciation. SICO's portfolio managers focus on identifying companies that are fundamentally strong, and that are trading at less than their fair values. Such an approach will continue to provide the Firm's clients with diversified, risk-averse and stable returns over the medium to long term.

The **success of the Seef Properties IPO** has set a new template for privatisation in Bahrain and the region as a whole. Many of the **innovative** aspects of the offering structure have been adopted by subsequent IPOs in other GCC states.

Risk Management

RISK MANAGEMENT

Risk management is the process of identifying the principal business risks facing SICO, establishing appropriate controls to manage those risks, and ensuring that appropriate monitoring and reporting processes are in place. SICO's process is consistent with prudent management required of a large financial organisation, but also balances cost against risk within the constraints of the Firm's risk appetite.

SICO is exposed to a wide variety of risks such as reputational, market, credit, operational, legal and regulatory risk. The Board considers reputational risk as the most significant risk for a business operating in the financial services sector. Awareness of the importance of SICO's reputation underpins its control culture. This risk could emanate as a result of a failure of financial, operational or compliance controls.

The risk management strategy currently adopted is based on a simplified framework for active banks with non-complex transactions. It is a structured and disciplined approach aligning business strategy, processes, people, technology and knowledge, with the purpose of evaluating and managing the risks that SICO faces.

There is a well-disciplined organisational structure to determine strategy, risk appetite, tolerance levels, planning and budgeting. Detailed budgets and plans, which are reviewed in light of the Firm's strategy and financial plans, are flexed to take account of potential adverse conditions, and are subject to rigorous testing at Management and Board levels. Detailed monthly accounts are produced, and variances and trends are closely monitored. Management reports each month to the Board or Executive Committee on performance and key issues affecting the Firm.

An independent Risk Management Unit provides leadership, direction and coordination of the efforts in managing the Firm's risks. It provides a holistic, integrated, future-focused, and process-oriented approach to enable SICO to balance its key business risks and opportunities with the intent of maximising returns and shareholder value.

Note 3 to the Financial Statements provides exhaustive commentary on the financial risk management. These are described below in brief.

Market Risk

Market risk is the risk of loss in the value of a financial instrument due to an adverse fluctuation in equity prices, interest rates, and foreign exchange rates, whether arising out of factors affecting a specific instrument, or the market in general.

Equity Price Risk

SICO's trading and available-for-sale portfolios are affected by equity price risk. This risk is mitigated by managing the portfolios within duly approved asset allocation matrix guidelines and other investment limits.

Interest Rate Risk

Debt instruments, placements, borrowings, and call deposits are subject to interest rate risk. The Treasury Unit carefully monitors these exposures in order to mitigate this risk. However, Treasury does not actively trade in money market instruments and therefore, these exposures are not hedged. Furthermore, SICO does not trade speculatively in derivatives.

Foreign Exchange Rate Risk

SICO's exposure to currency risk is minimal, due a substantial portion of business being transacted in Bahraini Dinar, other GCC currencies, and the US Dollar. The Bahraini Dinar and other GCC currencies are pegged to the US Dollar.

SICO's process is consistent with prudent management required of a large financial organisation, but also balances cost against risk within the constraints of the Firm's risk appetite.

Liquidity Risk and Funding

Liquidity risk is the risk that SICO is unable to meet its financial obligations as they fall due. It may result from an inability to sell a financial asset quickly at close to its fair value, or from an inability to raise funds quickly without undue cost. This risk arises principally from proprietary trading and investments, brokerage, asset management, and underwriting obligations. Treasury manages this risk by monitoring settlement obligations and maintaining sufficient liquid assets, including call deposits, and short-term placements. Liquidity position is monitored weekly by the Investment and Credit Committee, and during meetings of the Executive Committee and Board of Directors.

Credit Risk

SICO is subject to credit risk mainly in its brokerage activities, and issuer price risk in proprietary portfolios. These risks are monitored and controlled by means of exposure limits, approved in accordance with well-defined policies and procedures, by the Investment and Credit Committee, Executive Committee, or the Board. Additionally, SICO strictly adheres to the large exposure norms prescribed by the Central Bank of Bahrain.

Operational Risk

Operational risk is the risk of loss due to inadequate or failed internal processes, systems and people, or external events. Unlike market or credit risks, which are systemic in nature, operational risk is Firm-specific, and is inherent in the day-to-day operations of any bank. It includes a very broad spectrum of risks that could arise from a variety of reasons including, but not limited to, deficient transaction processing, business practices, employment practices, systems failures, and damage to physical assets. It also includes the risk of internal and external fraud.

SICO has a very conservative control consciousness, and adopts a number of mechanisms to manage this risk. These include a well-defined organisational structure, policies and procedures guidelines, segregation of duties, approval authorities, reconciliations, and tolerance limits for exposures. Internal Audit and the Regulatory Compliance Unit provide valuable support in this control activity.

Assets under Management has a range of controls to support the quality of the investment process, and is supervised by the Asset Management Committee. These are supported by strict operational controls to safeguard clients' assets, and there are regular reviews of investment management performance.

Corporate Finance activity is exposed to legal and reputational risk. Obtaining the necessary legal and regulatory approvals mitigates this risk. Advisory and Underwriting matters are monitored and controlled by the Investment and Credit Committee.

Corporate Governance

SICO is committed to upholding the highest standards of corporate governance. This comprises complying with regulatory requirements, protecting the rights and interests of all stakeholders, and achieving organisational efficiency. During 2007, the Board conducted a thorough review of the Firm's policies for corporate governance, internal controls, risk management and compliance, in accordance with the latest rules and guidelines from the Central Bank of Bahrain (CBB). In addition, a new management committee – IT Development Committee – was established.

Responsibilities

The Board of Directors is accountable to the shareholders for the creation and delivery of strong sustainable financial performance and long-term shareholder value. The Chairman is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the Executive Management, and maintaining a dialogue with the Firm's shareholders.

The Board has appointed two committees to assist it in carrying out its responsibilities: Executive Committee and Audit Committee. The Internal Audit function reports directly to the Board through the Audit Committee. The Board delegates the authority for management of the business to the Chief Executive Officer, who is supported by four management committees: Restricted Management Committee, Asset Management Committee, Investment and Credit Committee, and IT Development Committee.

Members of the Board and the Executive Management team are listed in the front section of this annual report.

Framework

SICO's corporate governance framework comprises a code of business conduct; operational policies and procedures; internal controls and risk management systems; internal and external audit and compliance procedures; effective communications and transparent disclosure; and measurement and accountability.

Code of Business Conduct

SICO conducts itself in accordance with the highest standards of ethical behaviour. A Code of Business Conduct has been developed to govern the personal and professional conduct of all stakeholders.

Compliance

As a licensed investment bank and listed company, SICO has in place comprehensive policies and procedures to ensure full compliance with the relevant rules and regulations of the Central Bank of Bahrain and the Bahrain Stock Exchange.

Communications

SICO conducts all communications with its stakeholders in a professional, honest, transparent, understandable, accurate and timely manner. Main communications channels include an annual report, corporate website, and regular announcements in the appropriate local media.

BOARD COMMITTEES

Executive Committee

Objective
To exercise the powers of the Board of Directors on matters of an important or urgent nature that arise between scheduled Board meetings.

Members

Mr. Albert Kittaneh	Chairman
Mr. Hussain Al Hussaini	Vice Chairman
Mr. Ali Rahimi	Member
Mr. Abdulaziz I. Al-Mulla	Member

Audit Committee

Objective
To review the Firm's financial reporting process, internal controls, risk management systems, and process for monitoring compliance with policies, procedures, laws, and regulations, and the Bank's own Code of Business Conduct.

Members

Mr. Anwar Abdulla Ghuloom	Chairman
Mr. Mahmoud Zewam	Member
Mr. Abdul Karim Bucheery	Member

MANAGEMENT COMMITTEES

Restricted Management Committee

Objective

To review the overall performance of each division against targets; review and decide on the implementation implications of new initiatives and products; and contribute to developing an ongoing strategy for the Firm.

Members

Chief Executive Officer	Chairman
Chief Operating Officer & Treasurer	Vice Chairman
Head of Brokerage	Member
Head of Asset Management	Member
Financial Controller	Member
Head of Operations	Member

Asset Management Committee

Objective

To review the investment strategy of the Firm's funds and portfolios; review and approve asset allocations; and review maturity mismatches, funding costs, foreign exchange risks, and credit concentration by country and industry/sector.

Members

Chief Executive Officer	Chairman
Chief Operating Officer & Treasurer	Vice Chairman
Head of Brokerage	Member
Head of Asset Management	Member
Head of Research	Member
Head of Risk Management	Member
Internal Auditor	Permanent Invitee
Head of Marketing	Permanent Invitee

Investment and Credit Committee

Objective

To approve investments within its discretionary powers as delegated by the Board; recommend healthy investments and risk management practices for consideration by the Executive Committee for those investments exceeding its discretionary powers; and monitor the Firm's investment activities.

Members

Chief Executive Officer	Chairman
Chief Operating Officer & Treasurer	Voting Member
Financial Controller	Voting Member
Head of Brokerage	Voting Member
Head of Asset Management	Voting Member
Head of Corporate Finance	Voting Member
Head of Risk Management	Voting Member
Head of Corporate Communications	Non-Voting Member
Head of Operations	Non-Voting Member
Head of Research	Non-Voting Member
Head of IT	Non-Voting Member

IT Development Committee

Objective

To act as the principal policy-making body responsible for the planning, implementation and future development of Information Technology & Communications within SICO.

Members

Head of Operations	Chairman
Financial Controller	Member
Head of IT	Member
Head of Risk Management	Member
Internal Auditor	Member
Business Unit Heads	as required and as voting members

Corporate Social Responsibility

As a leading Bahrain-based financial institution, SICO has long recognised its responsibility to support the social and economic well-being of the Kingdom. Accordingly, the Firm implements a corporate social responsibility programme that aims to contribute to the betterment of the local community, and the enhancement of Bahrain's reputation as the financial centre of the Middle East.

Supporting the betterment of the local community

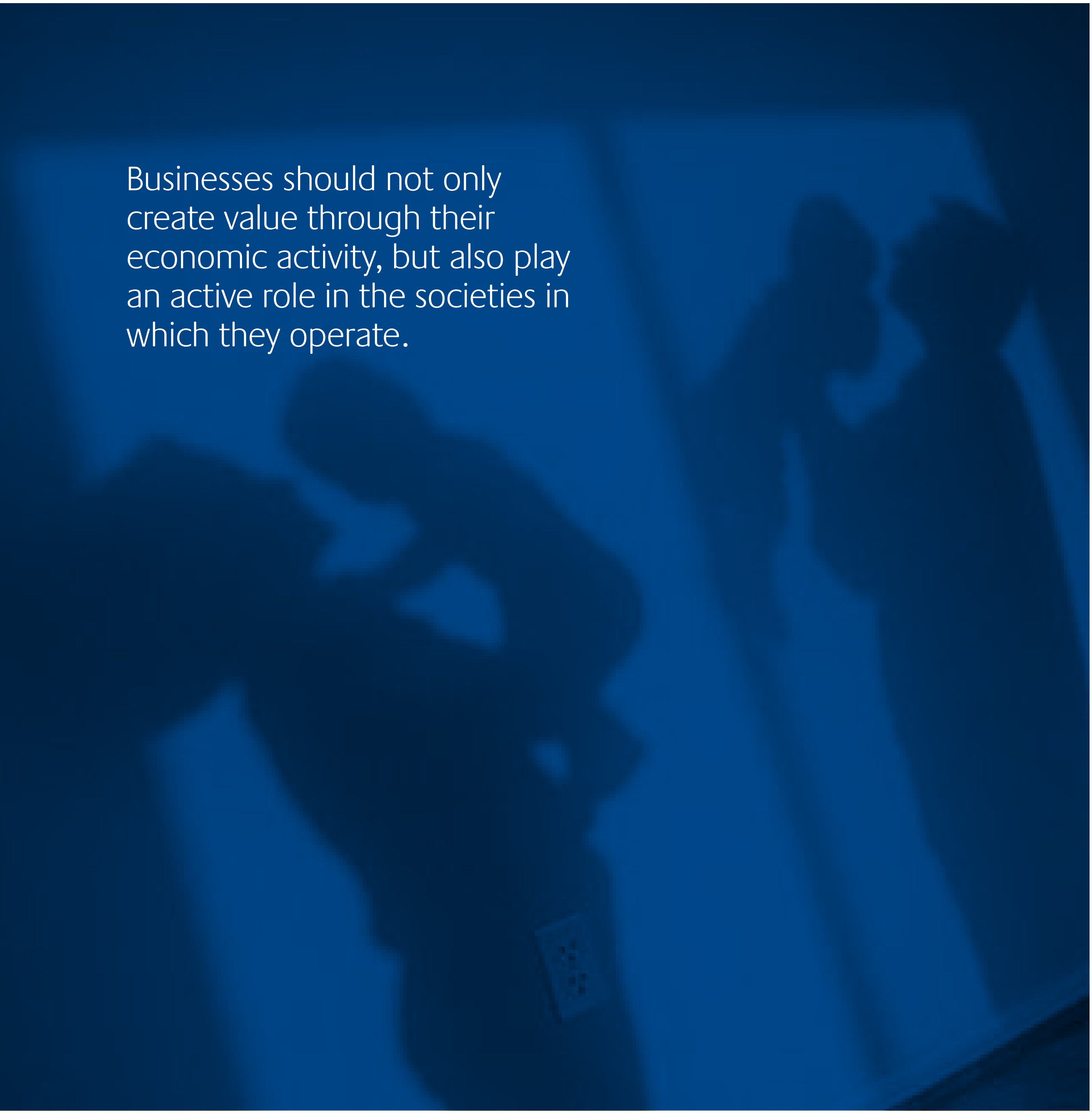
Education and healthcare are the fundamental building blocks of any modern society. This is especially the case for the Kingdom of Bahrain, whose key resource is its people. Through its annual donations programme of cash and equipment, SICO partners with institutions and charities in these sectors, working with them towards the betterment of society.

The beneficiaries in 2007 included the Bahrain Association for Mental Retardation; Bahrain Down Syndrome Society; Child Care Home; Be-Free Centre; American Mission Hospital; and Salmaniya Medical Centre, as well as several educational establishments. SICO also sponsored charitable fundraising events.

Supporting the growth of the financial sector

Bahrain's status as the financial centre of the Middle East is a key factor in the Kingdom's growing attractiveness as a destination for foreign investment. As such, SICO is committed to supporting the growth of the Kingdom's banking and financial services sector, and the development of the region's capital markets.

In 2007, the Firm sponsored and participated in the Government of Bahrain's 'Winning Formula' reception for delegates to the annual IMF meeting in Washington DC, which was organised by the Economic Development Board and the Bahrain Bankers' Society. SICO also sponsored the Financial Times Middle East Financial Services Summit, which was held in Bahrain during the year.



Businesses should not only create value through their economic activity, but also play an active role in the societies in which they operate.

Independent Auditors' Report
to the Shareholders

Securities and Investment Company BSC(c)
Manama, Kingdom of Bahrain
29 January 2008

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

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

Responsibility of the directors for the financial statements

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

The financial statements of the subsidiary companies have been audited by other auditors whose reports have been furnished to us and our opinion, in so far as it relates to the amounts included for these companies in the consolidated financial statements is based solely on those reports.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of 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 our 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, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

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

Report on other legal and regulatory requirements

In addition, in our opinion, the Bank has maintained proper accounting records and the consolidated 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. We are not aware of any violations of the Bahrain Commercial Companies Law 2001, the Central Bank of Bahrain and Financial Institutions Law 2006, the terms of the Bank's license or its memorandum and articles of association having occurred during the year ended 31 December 2007 that might have had a material 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.

Consolidated Balance Sheet

as at 31 December 2007

	Notes	**2007**	2006
		BD '000	BD '000
ASSETS			
Cash and cash equivalents	4	63,174	30,940
Investments at fair value through profit or loss	5	20,392	12,011
Available-for-sale investments	6	13,776	11,369
Furniture and equipment	7	128	140
Fees receivable	8	5,096	204
Other assets	9	2,266	2,397
Total assets		**104,832**	57,061
LIABILITIES			
Short-term borrowings	10	566	1,693
Payables to customers	11	53,661	25,660
Other liabilities	12	8,499	1,039
Total liabilities		**62,726**	28,392
EQUITY			
Share capital	13	13,921	13,910
Statutory reserve	14	3,415	2,212
General reserve	15	2,071	1,666
Available-for-sale securities fair value reserve		3,384	648
Retained earnings		19,315	10,233
Total equity (page 28)		**42,106**	28,669
Total liabilities and equity		**104,832**	57,061

Shaikh Mohammed Bin Isa Al Khalifa
Chairman

Albert I. Kittaneh
Vice Chairman and Chairman
of the Executive Committee

Anthony C. Mallis
Chief Executive Officer

The Board of Directors approved the consolidated financial statements consisting of pages 26 to 60 on 29 January 2008

Consolidated Income Statement
for the year ended 31 December 2007

	Notes	2007 BD '000	2006 BD '000
INCOME			
Interest income	16	1,563	1,238
Interest expense	16	(659)	(508)
Net interest income		**904**	730
Net fee and commission income	17	6,586	1,693
Net investment income	18	5,944	2,093
Brokerage and other income	19	2,547	2,063
Total income		**15,981**	6,579
EXPENSES			
Staff and related expenses	20	3,157	1,786
General, administration and other operating expenses	21	918	748
Total expenses		**4,075**	2,534
Net profit for the year		**11,906**	4,045
Earnings per share (fils)	26	**86**	29

Shaikh Mohammed Bin Isa Al Khalifa
Chairman

Albert I. Kittaneh
Vice Chairman and Chairman
of the Executive Committee

Anthony C. Mallis
Chief Executive Officer

The consolidated financial statements consist of pages 26 to 60

Consolidated Statement of Changes in Equity

for the year ended 31 December 2007

Bahraini Dinars '000

	Share capital	Statutory reserve	General reserve	Available-for-sale securities fair value reserve	Employee share grants reserve	Retained earnings	Total equity
As at 1 January 2007	13,910	2,212	1,666	648	-	10,233	28,669
Retained earnings adjustment of subsidiary	-	-	-	-	-	10	10
Available-for-sale securities							
Net changes in fair value	-	-	-	3,688	-	-	3,688
Net amount transferred to profit or loss on disposal	-	-	-	(952)	-	-	(952)
Total recognised income & expense directly in equity	-	-	-	2,736	-	-	2,736
Net income for the year	-	-	-	-	-	11,906	11,906
Total recognised income and expense for the year	-	-	-	**2,736**	-	**11,906**	**14,642**
Dividends for 2006	-	-	-	-	-	(1,113)	(1,113)
Transfer to general reserve for 2006	-	-	405	-	-	(405)	-
Remuneration paid to directors for 2006	-	-	-	-	-	(125)	(125)
Issue of shares to employees scheme	11	12	-	-	-	-	23
Transfer to statutory reserve for the year 2007	-	1,191	-	-	-	(1,191)	-
Balance at 31 December 2007	**13,921**	**3,415**	**2,071**	**3,384**	-	**19,315**	**42,106**
As at 1 January 2006	13,750	1,666	902	3,229	104	8,891	28,542
Available-for-sale securities							
Net changes in fair value	-	-	-	(1,031)	-	-	(1,031)
Net amount transferred to profit or loss on disposal	-	-	-	(1,550)	-	-	(1,550)
Total recognised income & expense directly in equity	-	-	-	(2,581)	-	-	(2,581)
Net income for the year	-	-	-	-	-	4,045	4,045
Total recognised income and expense for the year	-	-	-	(2,581)	-	4,045	1,464
Dividends for 2005	-	-	-	-	-	(1,384)	(1,384)
Transfer to general reserve for 2005	-	-	764	-	-	(764)	-
Remuneration paid to directors for 2005	-	-	-	-	-	(150)	(150)
Employee share grants for 2005	-	-	-	-	197	-	197
Issue of shares to employees scheme	160	141	-	-	(301)	-	-
Transfer to statutory reserve for the year 2006	-	405	-	-	-	(405)	-
Balance at 31 December 2006	13,910	2,212	1,666	648	-	10,233	28,669

The consolidated financial statements consist of pages 26 to 60

Consolidated Statement of Cash Flows

for the year ended 31 December 2007

	2007	2006
	BD '000	BD '000
Operating activities		
Net interest received	960	681
Sale of investments at fair value through profit or loss	33,823	8,822
Purchase of investments at fair value through profit or loss	(37,905)	(9,950)
Sale of available-for-sale investments	6,099	4,078
Purchase of available-for-sale investments	(4,818)	(4,856)
Net increase in payables to customers	31,392	15,944
Subscription money received for units of own funds not yet allotted	3,345	-
Dividends received	693	593
Brokerage and other fees received	4,274	8,334
Payments for staff and related expenses	(1,991)	(1,671)
Payments for general and administrative expenses	(744)	(896)
Deposit with BSE Guarantee Contribution Fund	(450)	-
Cash flows from operating activities	**34,678**	21,079
Investing activities		
Capital expenditure on furniture and equipment	(79)	(96)
Cash flows (utilised in) investing activities	**(79)**	(96)
Financing activities		
Repayment of short-term borrowings	(1,127)	(807)
Dividends paid	(1,113)	(1,384)
Directors' remuneration paid	(125)	(150)
Cash flow (utilised in) financing activities	**(2,365)**	(2,341)
Net increase in cash and cash equivalents	**32,234**	18,642
Cash and cash equivalents at the beginning of the year	30,940	12,298
Cash and cash equivalents at the end of the year (Note 4)	**63,174**	30,940

The consolidated financial statements consist of pages 26 to 60

1. STATUS AND OBJECTIVES

Securities and Investment Company BSC(c) ("the Bank") is a closed joint stock company registered in Bahrain under commercial registration number 33469 on 11 February 1995. The Bank commenced its operations in July 1995. In September 1997, the Bank obtained an investment banking licence from the Central Bank of Bahrain. On 7 May 2003, the Bank was listed on the Bahrain Stock Exchange as a closed company. In July 2007, the Bank was granted a conditional wholesale banking license by the CBB under Rule Book Volume 1.

The primary objectives of the Bank are:

- To act as a market maker at the Bahrain Stock Exchange;
- To assist in the development of the securities market in Bahrain by researching and promoting financial instruments and other investment vehicles;
- To arrange the issuance of bonds for developmental and investment purposes;
- To act as investment agents, trustees and intermediaries;
- To establish and manage investment and financial funds and portfolios;
- To offer financial advisory and underwriting services, such as advising corporations and family businesses on going public, and structuring transactions for privatisation programmes, mergers and acquisitions.

Principal activity

The Bank invests in securities in the Bahrain, GCC and global markets for its own account. It is an active broker in the Bahrain Stock Exchange and offers discretionary portfolio management services and margin trading to customers.

Subsidiaries

The Bank has three wholly owned subsidiaries authorised and approved by the Central Bank of Bahrain to carry on the business of collective investment schemes:

- SICO Funds Company BSC (c) ("Funds Company"). The Funds Company has launched SICO Selected Securities Fund ("SSSF"), the SICO Assured International Fund ("SAIF") and the 'Khaleej Equity Fund'.
- SICO Funds Company II BSC (c) launched SICO Arab Financial Fund
- SICO Funds Company III BSC (c) launched SICO Gulf Equity Fund

The Bank has also another wholly owned subsidiary company SICO Fund Services Company BSC (c) which provides custody and administration services.

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards, the Bahrain Commercial Companies Law 2001 and the Central Bank of Bahrain and Financial Institutions Law 2006.

During the period, the Group adopted IFRS 7 - Financial Instruments: Disclosures and revised IAS 1 - Presentation of Financial Statements – Capital Disclosures on their required application date of 1 January 2007. The adoption of IFRS 7 and the amendment to IAS 1 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the Group. In accordance with the transitional requirements of the standards, the Group has provided full comparative information.

Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis except for investment securities at fair value through profit or loss, available-for-sale securities and liabilities for cash settled share based payment arrangements, which are measured at fair value.

The investments in subsidiaries are carried at cost in the financial statements of the parent.

The accounting policies have been consistently applied by the Group and are consistent with those of the previous year.

Basis of consolidation

These consolidated financial statements include the accounts of the Bank and its wholly owned subsidiaries, (collectively "the Group"). All inter-company balances and transactions have been eliminated on consolidation.

Subsidiaries are those enterprises controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of the subsidiaries are included in the consolidated financial statements from the date the control by the parent commences until the date the control ceases.

Use of estimates and assumptions

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amount of financial assets and liabilities at the balance sheet date.

The use of estimates and assumptions is principally limited to the determination of impairment provisions for available for sale securities. The estimates and assumptions relating to provisions for impairment are described in more detail below in the accounting policy on provisions for impairment.

Judgments

In the process of applying the Group's accounting policies, management decides on acquisition of an investment whether it should be classified as at fair value through profit or loss, held-to-maturity securities or available-for-sale securities. The classification of each investment reflects the management's intention in relation to each investment and will be subject to different accounting treatments based on such classification.

Estimations
Impairment losses on available-for-sale investments

The Group determines that available-for-sale unquoted equity securities and managed funds are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment.

In making this judgment, the Group evaluates among other factors, the normal volatility in share price, evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

Foreign currencies
Functional and presentation currency

Items included in the financial statements of the Bank and its subsidiaries are measured based on the currency of the primary environment in which the entity operates (the functional currency). The consolidated financial statements are presented in Bahraini Dinars, representing the group's functional and presentation currency.

Transaction and balances

Transactions in foreign currencies are converted to Bahraini Dinars at rates of exchange prevailing at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to Bahraini Dinars at the market rates of exchange prevailing at the balance sheet date. Realised and unrealised foreign exchange profits and losses are included in other income except with regards to available for sale securities which are taken to equity.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment securities

(a) Classification

Trading securities classified as fair value through profit or loss are investments which the Group acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed together for short-term profit or position taking.

Available-for-sale securities are non-derivative investments that are not designated as another category of financial assets. These include investments in quoted and unquoted equity securities, floating rate bonds and certain managed funds.

Held-to-maturity securities are non-derivative assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity.

(b) Recognition and derecognition

Investment securities are recognised when the Group becomes a party to the contractual provisions of the instrument. Investment securities are derecognised if the Group's contractual rights from the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset.

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 are 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.

(c) Measurement

Trading securities classified at fair value through profit or loss are initially measured at cost, being their fair value, with transaction costs recognised directly in the income statement. Trading securities are subsequently re-measured to fair value at each reporting date with any resultant gain or loss recognised in the income statement.

Available-for-sale securities (AFS securities) are initially measured at cost, being their fair value, including transaction costs. Unrealised gains and losses arising from changes in the fair values of AFS securities are recognised in a reserve as a separate component of equity. In the event of sale, disposal, collection or impairment, the cumulative gains and losses recognised in equity are transferred to the income statement. Unquoted AFS equity securities whose fair value cannot be reliably measured are carried at cost.

Held-to-maturity securities are initially measured at cost. They are subsequently carried at amortised cost using the effective interest method.

(d) Fair value measurement principles

The determination of fair value of financial assets and liabilities is based on quoted market prices or dealer price quotations for financial instruments traded in active markets. For financial assets not traded on an active market, fair value is determined based on recent transactions or brokers' quotes.

(e) Impairment of investment securities

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset is impaired.

In the case of investments classified as available-for-sale, a significant or prolonged decline in the fair value below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial securities, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement.

Impairment losses recognised in the income statement on equity instruments are not subsequently reversed through the income statement.

Furniture and equipment

Furniture and equipment are stated at cost less accumulated depreciation and impairment losses, if any. The assets' residual values and useful lives are reviewed and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the carrying amount of the asset is greater than its estimated recoverable amount.

Depreciation is provided on cost by the straight-line method, which is intended to write off the cost of the assets over their expected useful life of three years.

Impairment of other assets

The carrying amount of the Group's assets, other than investment securities (refer 2(e)), is 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. All impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount.

Borrowings

Borrowings are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective interest method.

Employee benefits

(i) Bahraini Employees

Pensions and other social benefits for Bahraini employees are covered by the General Organisation for Social Insurance Scheme, to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis. The Group's share of contributions to this scheme, which is a defined contribution scheme under International Accounting Standard (IAS) 19 – Employee Benefits are charged to income in the year to which they relate.

(ii) Expatriate Employees

Expatriate employees are entitled to a leaving indemnity under the Bahrain Labour Law for the Private Sector 1976 based on length of service and final salary and other allowances paid. Provision for this unfunded commitment which represents a defined benefit plan under International Accounting Standard (IAS) 19 – Employee Benefits, has been made by calculating the notional liability had all employees left at the balance sheet date.

(iii) Share- Based Compensation

The Bank operates a discretionary share plan, which is designed to provide competitive long term incentives, is a cash-settled share based payment scheme. The total amount to be expensed ratably over the vesting period of five years is determined by reference to the fair value of the shares determined at the grant date and re-measured at every year end over the vesting period.

Dividends

Dividends payable to shareholders are recognised as a liability in the period in which such dividends are declared.

Cash and cash equivalents

For the purpose of the consolidated cash flows, cash and cash equivalents comprise cash and bank balances, call deposits and placements with banks that have an original maturity of three months or less when acquired.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fiduciary activities

The Group administers and manages assets owned by clients which are not reflected in the consolidated financial statements. Asset management fees are earned for providing investment management services and for managing mutual fund products. Asset administration fees are earned for providing custodial services. Fees are recognised as the services are provided.

Offsetting

Financial assets and liabilities are set off and the net amount reported in the balance sheet when the Group has a legally enforceable right to set off the recognised amounts and intends to settle either on a net basis, or to realise the asset and settle the liability simultaneously.

Earnings per share

The Group presents basic earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the year.

Interest income and expense

Interest income and expense is recognised in the income statement as it accrues, using the effective interest rate method. The effective interest rate is the rate that exactly discounts the estimated future cash flows through the expected life of the financial asset or liability to the carrying amount of the financial asset or liability. The effective rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

Fee and commission income and expense

Fee and commission income consists of custody fee, management fee and performance fee earned from Discretionary Portfolio Management Activity services offered by the Bank. These fees are recognised as the related services are performed.

Fee and commission expense consists of custody fee paid by the Group.

Net investment income

Net investment income includes all realised and unrealised fair value changes in the investment at fair value through profit or loss, realised gain/ losses on the available for sale investments and the related dividend income.

Dividend income is recognised when the right to receive the dividend is established.

Brokerage and other income

Brokerage and other income consists of brokerage income, investment banking income and marketing income. These fees are recognized when earned.

3. FINANCIAL RISK MANAGEMENT

(a) Introduction and overview

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risk
- operational risk

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital.

Risk management framework

The Board of Directors (the "Board") has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board is assisted in this function by the Executive Committee.

The Board has set up an independent Risk Management Unit that provides leadership, direction and coordination of the efforts in managing the risks. It provides a holistic, integrated, future-focused, and process-oriented approach to enable the Group to balance its key business risks and opportunities with the intent of maximising returns and shareholder value.

The Audit Committee of the Board is responsible for monitoring compliance with the Bank's policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by the Internal Audit Function which undertakes regular reviews of risk management controls and procedures, the results of which are reported to the Audit committee.

(b) Credit risk

Credit risk is the risk that a customer or counterparty to a financial asset fails to meet its contractual obligations and cause the Group to incur a financial loss. The credit risk for the Group arises principally from its brokerage activities and issuer price risk in proprietary portfolios. Counterparty credit risk consists of two categories of risks – Pre-Settlement and Settlement risks. In Brokerage Department, counterparty credit risk arises vis-a-vis trading counterparties and counterparty brokers. In Asset Management and Investment and Treasury Departments, deals routed through counterparty brokers gives rise to counterparty credit risk.

Management of credit risk

The Group limits its credit risk by applying well-defined credit policies and procedures laid down by the Board of Directors and Executive Committee.

The Group manages the Counterparty Risks for brokerage clients by conducting a credit evaluation of the clients and counterparty brokers of GCC and other exchanges is undertaken, using financial and other parameters.

The risks in proprietary portfolios are monitored and controlled by means of Asset Allocation guidelines and exposure limits approved in accordance with well-defined Investments policies and procedures, by the SICO Investment and Credit Committee (SICC), Executive Committee or Board, as appropriate. Additionally, the Group strictly adheres to the large exposure norms prescribed by the Central Bank of Bahrain.

Regular audits of business units and Group credit processes are undertaken by Internal Audit.

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Exposure to credit risk

The Group's maximum exposure to credit risk is as follows:

	2007	2006
	BD '000	BD '000
Cash and cash equivalents	63,174	30,940
Investments at fair value through profit or loss	20,392	12,011
Available for sale investments	13,776	11,369
Fee receivable	5,096	204
Receivables and other assets	1,843	2,352
	104,281	56,876

Currently only the Margin Trading Lending on the Bahrain Stock Exchange is subject to formal collateral arrangement. This scheme is undertaken in accordance with the related regulation issued by the Central Bank of Bahrain. The shares in the Margin Trading portfolio is held as collateral against the amount lent to the customer. Such shares are marked to market on a daily basis. If there is any deficit in the minimum equity ratio, then a maintenance margin call is issued. Additionally, brokerage client agreements have a clause that the Group has a right to liquidate the client's shares under its custody, if such client fails to honour its obligations.

The Group assesses impairment for each financial asset specifically and does not assess impairment on a portfolio basis. This is primarily as the Group's exposure is mainly in investment in equity securities, which are not considered to have common credit characteristics to form a portfolio.

The Group writes off a customer/ investment balance when the Group determines that carrying amounts are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the customer/ issuer's financial position such that the customer/ issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

Concentration of investments

Investments at fair value through profit or loss and available for sale investments are carried at fair value.

The Group monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk at the reporting date is shown below:

Distribution by sector	**Investments at fair value through profit or loss**		**Available for sale investments**	
	2007	2006	**2007**	2006
	BD '000	BD '000	BD '000	BD '000
Commercial banks	1,366	992	1,863	1,516
Other banks	2,615	636	1,086	2,575
Insurance	34	15	-	-
Services	3,517	1,582	1,167	1,362
Managed funds	8,248	6,418	6,016	4,255
Government bonds	-	-	-	286
Others	4,612	2,368	3,644	1,375
	20,392	12,011	13,776	11,369
Less: Impairment allowance	-	-	-	-
Total carrying amount	**20,392**	12,011	**13,776**	11,369

Geographical distribution	**Investments at fair value through profit or loss**		**Available for sale investments**	
	2007	2006	**2007**	2006
	BD '000	BD '000	BD '000	BD '000
GCC countries	13,034	6,097	9,589	9,415
USA	1,889	1,525	4,138	1,883
Europe	2,639	2,459	49	71
Middle East and North Africa	2,830	1,930	-	-
	20,392	12,011	13,776	11,369
Less: Impairment allowance	-	-	-	-
Total carrying amount	**20,392**	12,011	**13,776**	11,369

Concentration by location for investments is measured based on the location of the issuer of the security.

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3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Settlement risk

The Group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a counter party to honour its obligations to deliver cash, securities or other assets as contractually agreed.

(c) Liquidity risk

Liquidity risk, also referred to as funding risk, is the risk that an enterprise will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity Risk is managed for all the three risk originating departments - Asset Management, Brokerage and Investments and Treasury.

It originates from the mismatches in the maturity pattern of assets and liabilities or other defaults that could result in its funding and credit lines drying up. Measuring and managing liquidity needs are considered vital for effective operation of the Bank.

At present, the Group's liquidity risk exposure is minimal because a high proportion of funds is placed with banks as short-term deposits and, on maturity, deposits are transferred to current accounts based on expected requirements.

The Bank faces three types of liquidity risks as follows:

- Funding Risk – need to replace net outflows due to unanticipated withdrawal/non-renewal of call deposit accounts, borrowing or inability to liquidate financial assets in time;
- Operating Liquidity - need to compensate for low liquidity of investments or markets and non-receipt of expected inflows of funds;
- Call Risk - due to crystallisation of contingent, off balance sheet liabilities and inability to undertake profitable business opportunities when desirable.

Management of liquidity risk

Liquidity risk is currently managed by the Treasury unit monitoring the cash flow and funding requirements on a daily basis. Credit Lines have been established with a few banks and financial institutions to be drawn upon in case of need. The Bank also plans to create an ALCO (Asset-Liability Management Committee) to closely supervise the liquidity management and associated risks.

The residual contractual maturity of financial liabilities is as follows:

2007	**Carrying value**	**Gross outflow**	**Less than 1 year**	**1 to 5 years**	**Above 5 years**
Liabilities					
Short term borrowings	566	600	600	-	-
Customer accounts	53,661	53,661	53,661	-	-
Other liabilities	7,536	7,536	7,536	-	-
	61,763	**61,797**	**61,797**	-	-

2006	Carrying value	Gross outflow	Less than 1 year	1 to 5 years	Above 5 years
Liabilities					
Short term borrowings	1,693	1,708	1,708	-	-
Customer accounts	25,660	25,660	25,660	-	-
Other liabilities	970	970	970	-	-
	28,323	28,338	28,338	-	-

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(d) Market risks

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether these changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market.

The Bank, as part of its normal operations, is exposed to market risk with regard to its investments in trading and available-for-sale securities. However, this risk is controlled by appropriate management review and monitoring through the Investment Portfolio and Market Making Policies and Guidelines set by the Executive Committee and the Group's management.

Market Risk Management thus involves management of equity price risk, interest rate risk and foreign exchange risk.

(d) (i) Equity Price Risk

Equity investment activities have a significant impact on earnings and business relationships in the bank. Only the equities in the trading book are considered by the Bank for the purpose of market risk management and market risk capital computation.

Active management of investments is a well-known method of risk management in equities. Portfolio diversification on the basis of industry, sector, geographic, and market factors enables the Bank to diversify its risks. There are well defined Investment Policies and Procedures approved by the Board that govern the Trading as well as Available for Sale Portfolios.

Formal valuation policies that specify appropriate and sound portfolio valuation methodologies have been established for investments in listed companies and indirect fund investments. Marking the equity portfolio to market on a daily basis ensures that the unrealized gains and lossess are accounted for on a daily basis. Externally managed funds and portfolios are valued at Net Asset Value provided by the external investment managers on a monthly basis.

Portfolio-valuation methodologies conform to accepted accounting principles and are based on sound, empirically acceptable approaches that are clearly articulated, well documented, and applied consistently across similar investments over time.

The mechanism for managing Equities Price Risk is explained below:-

Limit Management

Limits are broadly of two types – Nominal Limits and Risk Based Limits. Initially, the Bank has adopted nominal limits and has a plan to introduce risk based limits and parameters in the future. Nominal Limits include counterparty credit / exposure limits, stop loss limits, concentration limits etc., which are monitored by adopting an approved Asset Allocation Matrix. This matrix also includes the Available for Sale portfolio.

Sensitivity Analysis of a 1% change in market prices on the un-realised profit or loss for the investments at fair value through profit or loss portfolio and AFS reserve is given below:

	Investments at fair value through profit or loss		**Available for sale investments**	
	2007	2006	**2007**	2006
Increase of 1%	203,894	113,717	137,848	120,109
Decrease of 1%	(203,894)	(113,717)	(137,848)	(120,109)

(d) (ii) Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.

The investments in debt instruments, placements, borrowings and call deposits are subject to interest rate risk. The Treasury Unit carefully monitors these exposures in order to mitigate this risk.

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3. FINANCIAL RISK MANAGEMENT (CONTINUED)

The Bank minimises its exposure to interest rate risk by careful monitoring of exposures. Placements and call deposits with banks are at fixed interest rates and mature within three months. The liabilities of the Bank include customer advances that bear interest at prevailing market rates.

The Bank invests client funds (excess funds in call accounts) in various banks with a view to earn interest on these funds. The interest thus earned (minus a spread and administrative costs) is passed on to the customers. As a particular rate of interest is not contracted with the client the upward or downward movements in interest rates does not affect the Bank adversely.

The Bank maintains cash balances with various banks in different currencies to meet liquidity requirements for equity share deals settlement in these currencies. These arise due to the need for timely payment of settlement amounts by clients as well as proprietary trades.

The Bank has exposures to debt instruments issued by GCC institutions in its proprietary portfolios. There is no ready market for selling these instruments and can only be traded Over-The-Counter. Investments in debt instruments are approved only based on structured analysis of the proposed investment and the issuer. All debt instruments are unrated.

The Bank follows the Standardised Methodology for managing interest rate risk, where the risk exposures in fixed income securities are measured using a two pronged approach – measuring the issuer risk and general market risk. The Duration Gap approach methodology is used for this and the discounted cash flow for fair valuation of the fixed income securities.

Interest rate re-pricing profile

2007	Effective interest rate % p.a.	Within 1 year	Over 1 year	Non-interest sensitive	Total
Cash and bank		-	-	15,230	15,230
Call deposits		850	-	-	850
Placements with banks	3.77	47,101	-	-	47,101
Investments at fair value through profit or loss	6.30	860	469	19,063	20,392
Available-for-sale securities	6.59	-	400	13,376	13,776
Furniture and equipment		-	-	128	128
Fees receivable		-	-	5,096	5,096
Other assets		-	-	2,266	2,266
Total assets		**48,811**	**869**	**55,159**	**104,839**
Bank overdrafts	9.75	7	-	-	7
Short term borrowings	5.91	566	-	-	566
Customer accounts	2.13	13,334	-	40,327	53,661
Other liabilities		-	-	8,499	8,499
Total liabilities		**13,907**	**-**	**48,826**	**62,733**
Equity		**-**	**-**	**42,106**	**42,106**
Total liabilities and equity		**13,907**	**-**	**90,932**	**104,839**
Interest rate sensitivity gap		34,904	869	(35,773)	-
Cumulative interest rate sensitivity gap		34,904	35,773	-	-

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2006	Effective interest rate % p.a.	Within 1 year	Over 1 year	Non-interest sensitive	Total
Cash and bank		-	-	5,082	5,082
Call deposits		517	-	-	517
Placements with banks	5.35	25,399	-	-	25,399
Investments at fair value through profit or loss	5.00	-	43	11,968	12,011
Available-for-sale securities	4.18	476	400	10,493	11,369
Furniture and equipment		-	-	140	140
Fees receivable		-	-	204	204
Other assets		-	-	2,397	2,397
Total assets		26,392	443	30,284	57,119
Bank overdrafts	9.75	58	-	-	58
Short term borrowings	5.61	1,693	-	-	1,693
Customer accounts	3.87	20,386	-	5,274	25,660
Other liabilities		-	-	1,039	1,039
Total liabilities		22,137	-	6,313	28,450
Equity		-	-	28,669	28,669
Total liabilities and equity		22,137	-	34,982	57,119
Interest rate sensitivity gap		4,255	443	(4,698)	-
Cumulative interest rate sensitivity gap		4,255	4,698	-	-

* At 31 December 2007 the effective interest rate on Bahraini Dinar call deposits was 2.875 % - 3.125 % p.a. (2006: 4.625% – 4.875% p.a.) and on USD call deposits was 3.50 % – 3.75 % p.a. (2006: 5.75 % – 5.00 % p.a.).

(d) (iii) Exchange risk

Exchange rate risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign currency exchange rates. Most of the Bank's foreign currency exposures are in GCC currencies and United States Dollar. Such exposures include short-term fixed deposits, investments in securities and due from/ to customers. Since the Bahraini Dinar is effectively pegged to the US Dollar, currency risk is minimal. The Bank does not hedge its currency risk.

(e) Operational risk

Operational risk is the risk of loss due to inadequate or failed internal processes, systems and people or external events. Unlike market or credit risks, which are systemic in nature, operational risk is Firm-specific and is inherent in the day-to-day operations of any bank. It includes a very broad spectrum of risks that could arise from a variety of reasons including, but not limited to, deficient transaction processing, business practices, employment practices and systems failures, and damage to physical assets. It also includes the risk of internal and external fraud.

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

The Bank has a very conservative control consciousness and adopts a number of mechanisms to manage this risk. These include a well-defined organizational structure, policies and procedures guidelines, segregation of duties, approval authorities, reconciliations, and tolerance limits for exposures. Internal Audit and Regulatory Compliance Unit provides support in this control activity. Regular custodial position reconciliations and bank reconciliations provide key strengths to mitigate operational risks. There is also a professional indemnity insurance cover in place.

Another endeavor of the Bank's operational risk management is to usher in straight through processing (STP) to enable seamless processing and reduce operational errors and optimize productivity. There is a well laid out plan to introduce middle office functionalities to ensure better compliance management. The Bank has a project in progress to upgrade the core banking system and office automation and is expected to be completed by the end of 2008.

Assets under management activity has a range of controls to support the quality of the investment process and is supervised by an Asset Management Committee. These are supported by strict operational controls to safeguard clients' assets, and there are regular reviews of investment management performance.

Corporate Finance activity is exposed to legal and reputational risk. Obtaining the necessary legal and regulatory approvals mitigates this risk. Advisory and underwriting matters are monitored and controlled by the SICO Investment and Credit Committee (SICC).

Regulatory compliance including Anti-money laundering compliance program also forms a key component of risk management. Board and Management attach high importance to these matters of strategic importance. There are well laid out policies and procedures to achieve compliance with regulatory matters.

(f) Capital Management

The Central Bank of Bahrain (CBB) sets and monitors capital requirements for the Group as a whole. In implementing the current capital requirements, the CBB requires the Group to maintain a prescribed ratio of total capital to total risk-weighted assets. The Bank's policy is to maintain sufficient capital to sustain investor and market confidence and to support future development of the business. There were no changes in the Group's approach to capital management during the year. Further details on capital management are set out in the note on capital adequacy (Note 30).

4. CASH AND CASH EQUIVALENTS

	2007	2006
	BD '000	BD '000
Cash and bank balances	15,230	5,082
Call deposits	850	517
Short term placements with Banks	47,101	25,399
	63,181	30,998
Bank overdraft	(7)	(58)
As at 31 December	**63,174**	30,940

Call deposits and placements are with banks of good credit standing and earn interest at prevailing rates. The Bank uses external ratings as part of credit appraisal process for exposures to banks within established country limits.

The bank overdraft bears interest at prevailing market rates. As at 31 December 2007, the effective interest rate on borrowings was 9.75% (2006: 9.75%).

5. INVESTMENTS AS FAIR VALUE THROUGH PROFIT OR LOSS

	2007	2006
	BD '000	BD '000
Held for trading		
Listed shares	10,385	4,388
Managed funds	8,678	6,418
Debt securities	1,329	1,205
Carrying value at 31 December	**20,392**	12,011

6. AVAILABLE-FOR-SALE INVESTMENTS

	2007	2006
	BD '000	BD '000
Listed shares	6,987	6,239
Managed funds	6,389	4,255
Debt securities	400	875
Carrying value at 31 December	**13,776**	11,369

7. FURNITURE AND EQUIPMENT

	2007	2006
	BD '000	BD '000
Cost as at 1 January	520	437
Additions	81	96
Disposals	(17)	(13)
Cost at 31 December	**584**	520
Depreciation as at 1 January	380	323
Charge for the year	91	70
Disposals	(15)	(13)
Depreciation as at 31 December	**456**	380
Net book value at 31 December	**128**	140
Cost of fully depreciated assets in use	**327**	277

Furniture and equipment comprises furniture, fixtures and fittings, office equipment, computer hardware and software and vehicles.

8. FEE RECEIVABLE

Fee receivable mainly represents the management and performance fee receivable by the Bank from its DPMA clients and own funds.

	2007	2006
	BD '000	BD '000
Management fee	366	204
Performance fee	4,568	-
Custody fee	162	-
As at 31 December	**5,096**	204

9. OTHER ASSETS

	2007	2006
	BD '000	BD '000
Receivables from clients and brokers	1,244	1,806
Guarantee deposit with the Bahrain Stock Exchange	500	50
ESOP share advance account	323	-
Prepaid expenses	100	45
Interest receivable	53	82
Other receivables	46	414
As at 31 December	**2,266**	2,397

10. SHORT-TERM BORROWINGS

	2007	2006
	BD '000	BD '000
Borrowings from a local non-bank institution	-	750
Bank borrowings	566	943
As at 31 December	**566**	1,693

These Borrowings are unsecured with interest at prevailing market rates.

11. PAYABLES TO CUSTOMERS

Payable to customers include settlement amounts for trades executed on behalf of customers and margin deposits for the brokerage and DPMA services offered by the Bank. Interest on certain deposit accounts is paid as per the arrangement with the customers subject to a minimum balance. Interest expense on these deposits for 2007 amounted to BD 503 (2006: 375).

12. OTHER LIABILITIES

	2007	2006
	BD '000	BD '000
Subscription money for units of own funds not yet allotted	3,345	-
Brokerage payable to counterparty	2,840	-
Accrued expenses	460	591
Provision for employee indemnities	94	68
ESOP liability	869	-
Other payables	891	380
As at 31 December	**8,499**	1,039

13. SHARE CAPITAL

	2007	2006
	BD '000	BD '000
Authorised share capital		
500,000,000 shares of 100 fils each	**50,000**	50,000
Issued and fully paid		
At 1 January	13,910	13,750
Issue of shares to trustees	11	160
At 31 December	**13,921**	13,910

During the current year, the Bank issued 107,837 shares of BD 100 fils each under the employee share option for the year 2006 to HSBC Trustee (C.I) Limited at a premium of 106 fils (2006: 1,597,261 shares of 100 fils each for the year 2004 and 2005 at a premium of 68 fils and 108 fils respectively).

The Board of Directors has proposed a cash dividend 10 fils per share of 100 fils nominal value, a 10% dividend (2006: 8 fils per share of 100 fils nominal value, a dividend of 8%), Directors remuneration of BD 200,000 (2006: BD 125,000) is also proposed. Proposed appropriations are in accordance with the Bank's Articles of association and are subject to approval by the shareholders at the Annual General Meeting.

	2007	2006
	BD '000	BD '000
Directors' remuneration	200	125
Proposed dividend	1,392	1,113
General reserve	1,191	405

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13. SHARE CAPITAL (CONTINUED)

The shareholders are:	**2007**		2006	
	Capital	Percentage %	Capital	Percentage %
Pension Fund Commission	3,107.5	22.3	3,107.5	22.4
General Organisation for Social Insurance	2,200	15.8	2,200	15.8
Bank of Bahrain and Kuwait BSC	1,375	9.9	1,375	9.9
National Bank of Bahrain BSC	1,375	9.9	1,100	7.9
Arab Investment Resources Company EC	1,100	7.9	1,100	7.9
Gulf International Bank BSC	1,100	7.9	1,100	7.9
Arab Banking Corporation BSC	1,100	7.9	1,100	7.9
Gulf Investment Corporation GSC	1,100	7.9	1,100	7.9
Ahli United Bank (Bahrain) BSC	605	4.3	605	4.3
Bahrain Middle East Bank EC	412.5	3	412.5	3
Bahraini Saudi Bank BSC	275	2	275	2
TAIB Bank BSC	-	-	275	1.9
HSBC Trustee (C.I) Limited	171	1.2	160	1.2
	13,921	**100.0**	13,910	100.0

Based on these financial statements, the Net Asset Value per share is BD 0.302 (2006: BD 0.206)

14. STATUTORY RESERVE

In accordance with the Bahrain Commercial Companies Law 2001, 10 percent of net profit is appropriated to a statutory reserve, which is not normally distributable except in accordance with Article 224 of the law. Such appropriations may cease when the reserve reaches 50 percent of paid up share capital. During the year the share premium of BD 12 (2006: BD 141) arising from the issue of shares under employee share option plan has been adjusted to statutory reserve.

15. GENERAL RESERVE

In accordance with the Bank's Articles of Association and the recommendations of the Board of Directors, specific amounts are transferred to the general reserve in the current year. The reserve carries no restriction in its distribution. The board of directors have proposed a transfer of BD 1,191 (2006: BD 405) to the general reserve in the current year. This is subject to the approval of the shareholders at the Annual General Meeting.

16. INTEREST INCOME/ INTEREST EXPENSE

	2007	2006
	BD '000	BD '000
Interest income		
Placements and call deposits	1,353	1,032
Investments carried at fair value through profit or loss	25	48
Available for sale investments	90	101
Customer accounts	95	57
	1,563	1,238
Interest expense		
Borrowings	156	133
Customer accounts	503	375
	659	508

17. FEE AND COMMISSION INCOME/ EXPENSE

	2007	2006
	BD '000	BD '000
Fee and commission income from trust or other fiduciary activities		
- Management fee	1,722	1,565
- Performance fee	4,657	2
- Custody fee	356	128
	6,735	1,695
Fee and commission expense		
- Custody fee	(149)	(2)
	6,586	1,693

18. NET INVESTMENT INCOME

	2007	2006
	BD '000	BD '000
Net gain/ (loss) on investments carried at fair value through profit or loss	4,299	(50)
Realised gain on sale of available-for-sale investments	952	1,550
Dividend income on investments carried at fair value through profit or loss	237	129
Dividend income on available for sale investments	456	464
	5,944	2,093

Net gain/ (loss) on investments carried at fair value through profit or loss comprises the following:

	2007	2006
	BD '000	BD '000
Realised gain/ (loss) on sale	1,372	(266)
Unrealised gain representing fair value adjustments	2,927	216
	4,299	(50)

19. BROKERAGE AND OTHER INCOME

	2007	2006
	BD '000	BD '000
Brokerage income	1,445	1,613
Investment banking income	639	339
Marketing income	69	12
Foreign exchange gain	348	94
Other income	46	5
	2,547	2,063

20. STAFF AND RELATED EXPENSES

	2007 BD '000	2006 BD '000
Salaries and allowances	2,915	1,538
Social security costs	108	87
Other costs	134	161
	3,157	1,786

As at 31 December 2007, the Group employed 49 (2006: 49) Bahrainis and 18 (2006: 17) expatriates.

The Group's contributions for the year to the General Organisation for Social Insurance in respect of its employees amounted to BD 82 (2006: BD 65).

Other liabilities include a provision of BD 94 (2006: 68) for the unfunded obligation relating to leaving indemnities payable to expatriate employees.

21. GENERAL, ADMINISTRATION AND OTHER OPERATING EXPENSES

	2007 BD '000	2006 BD '000
Rent	128	148
Communication expenses	144	103
Marketing expenses	261	178
Professional fees	156	111
Other operating expenses	138	138
Depreciation	91	70
	918	748

22. RELATED PARTY TRANSACTIONS

Transactions with funds owned by the Subsidiary Companies

The Group provides management services to the funds owned by the subsidiary companies namely SICO Funds Company BSC (c), SICO Funds Company II BSC (c) and SICO Funds Company III BSC (c) in the ordinary course of business and also has investments in certain funds.

	2007	2006
	BD '000	BD '000
Fee and commission income	**1,986**	404
Fee receivable	**1,633**	92
Available for sale investments		
- Khaleej Equity Fund	**910**	625
- SICO Selected Securities Fund	**670**	506
Investments carried at fair value through profit or loss		
- Khaleej Equity Fund	**245**	165
- SICO Arab Financial Fund	**930**	-

Transactions with shareholders

The Group obtains short term borrowings from its non-bank shareholders. The Group has banking relationships, makes deposits and placements, obtains short term borrowings and has unutlised credit facilities with certain of its shareholders that are local banks. All such transactions are in the ordinary course of business and on normal commercial terms.

The Group also provides discretionary portfolio management account services to two of its shareholders in the ordinary course of business. These services are provided on normal commercial terms and conditions and the related funds are held by the Group in a fiduciary capacity.

	2007	2006
	BD '000	BD '000
Fee and commission income	**1,902**	236
Borrowings as at 31 December	**-**	1,127
Borrowings obtained during the year	**5,416**	2,075
Borrowings repaid during the year	**(6,543)**	(2,882)

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Key Management Personnel

Key Management Personnel of the Group are those persons having the authority and responsibility for planning, directing and controlling the activities of the entity. The key management personnel comprise of the members of the board of directors and the chief executive officer.

Compensation paid/ payable to key management personnel are as follows:

	2007	2006
Short term benefits	425	468
Post employment benefits	15	11
Equity compensation benefits	838	49
	1,278	528

General and administrative expenses include BD 33 (2006: BD 24) towards attendance fees and other related expenses for members of the Board and Executive Committee.

23. EMPLOYEE SHARE OPTION PLAN

The Group has established an Employee Share Option Plan ("the Plan") which is operated through a Trustee. The Trustee has been set up by the transfer of shares of the Bank allotted to the employees under the Plan.

Under the Plan, employees are entitled to receive shares as part of their bonus in ratios determined by the Board of Directors. The value of the shares is to be determined based on the fair value of the Group's net assets as at the reporting date. This Plan is treated as a cash-settled share based payment transaction due to the restrictions imposed under the Plan whereby the employees have to sell back the shares to the Group on resignation/ retirement based on the vesting conditions mentioned in the Plan.

On issue of shares under the Plan, the share capital is increased with a corresponding increase in ESOP share advance account classified under other assets. The ESOP share advance account as at 31 December 2007 amounted to BD 323 (2006: Nil).

The Group has recognised an employee liability of BD 869 (2006: Nil) on the shares granted till date. This liability has been determined on the fair value of the Group's net assets as at 31 December 2007 in accordance with the rules of the Plan.

The movement in the shares issued under the Plan is as follows:

		2007		2006
	No. of shares issued	**Value**	No. of shares issued	Value
As at 1 January	1,597,261	301	-	-
Shares issued during the year	**107,837	22	*1,597,261	301
As at 31 December	**1,705,098**	**323**	1,597,261	301

** In 2007, the Bank issued 107,837 new shares under the Plan for the year 2006 as approved by the Board of Directors (636,789 eligible shares net of 528,952 shares pertaining to employees who left the Group during the year whose obligation was cash settled).

* During 2006, shares for the year 2004 (778,227) and 2005 (819,034) were issued by the Bank.

For the year 2007, the Board of Directors has granted shares under the Plan amounting in value to BD 420. Based on the NAV of 0.302 as at 31 December 2007, the obligation of BD 420 represents 1,389,073 shares that will be issued to the employees in 2008. As at 31 December 2007, this obligation is accounted for as part of the provision for bonus under other liabilities.

24. CONTINGENCIES, COMMITMENTS AND MEMORANDUM ACCOUNTS

Investment commitment

The Bank has committed to invest in SICO Selected Securities Fund a minimum of 5% of the fund's net asset value and 10% of the net assets value of the Khaleej Equity Fund at any time throughout its life.

	2007	2006
	BD '000	BD '000
Funds under management (net asset value)		
SICO Selected Securities Fund	**7,514**	5,926
Khaleej Equity Fund	**24,017**	11,916
SICO Gulf Equity Fund	**16,821**	11,548
SICO Arab Financial Fund	**8,388**	-
Discretionary Portfolio Management Account	**173,108**	102,382

The Bank is the fund manager for "SICO Selected Securities Fund" launched in April-May 1998, "Khaleej Equity Fund" launched in March 2004, "SICO Gulf Equity Fund" launched in March 2006 and "SICO Arab Financial Fund" launched in August 2007. The net asset value of the SICO Selected Securities Fund, Khaleej Equity Fund, SICO Gulf Equity Fund and SICO Arab Financial Fund are based on audited accounts as at 31 December 2007.

The funds under discretionary portfolio management account were held in trust or in a fiduciary capacity and are not treated as assets of the Group and, accordingly, have not been included in the consolidated financial statements.

	2007	2006
	BD '000	BD '000
Securities under management custody	**1,464,413**	236,548

The Group provides custodianship and nominee services in respect of marketable securities. At 31 December 2007, marketable securities amounting to BD 1,464,413 (2006: BD 236,548) were held by the Group as custodian under Brokerage and Custodianship Contracts, out of which securities amounting to BD 276,440 (2006: BD 117,363) were registered in the name of the Bank.

25. SIGNIFICANT NET OPEN FOREIGN CURRENCY POSITIONS

	2007	2006
	BD '000	BD '000
US Dollar (long position) – unhedged	**11,011**	36,058
KWD (long position) – unhedged	**4,490**	3,954
SAR	**9,034**	1,805

The Bahraini Dinar is effectively pegged to the US Dollar at USD 1 = BD 0.377

26. EARNINGS PER SHARE

	2007	2006
Net income	11,906	4,045
Weighted average number of shares issued (In 000's)		
Ordinary shares as at 1 January	139,097	137,500
Shares issued under ESOP during the year	108	1,597
Weighted average number of shares as at 31 December	139,174	138,904
Earnings per share	**86**	29

Diluted earnings per share have not been presented as the Group has no commitments that would dilute earnings per share.

27. MATURITY PROFILE OF ASSETS, LIABILITIES AND EQUITY

As at 31 December 2007	Less than 1 year	1 to 5 Years	Above 5 Years	Total
Assets				
Cash and bank	15,230	-	-	15,230
Call deposits	850	-	-	850
Placements with banks	47,101	-	-	47,101
Investments at fair value through profit or loss	19,063	1,329		20,392
Available-for-sale securities	-	400	13,376	13,776
Furniture and equipment		128	-	128
Fees receivable	5,096	-	-	5,096
Other assets	2,266	-	-	2,266
Total assets	**89,606**	**1,857**	**13,376**	**104,839**
Liabilities				
Bank overdrafts	7	-	-	7
Short term borrowings	566	-	-	566
Customer accounts	53,661	-	-	53,661
Other liabilities	8,499	-	-	8,499
Total liabilities	**62,733**	-	-	**62,733**
Equity	-	-	42,106	**42,106**
Total liabilities and equity	**62,733**	-	**42,106**	**104,839**
Liquidity gap	26,873	1,857	(28,730)	-
Cumulative liquidity gap	26,873	28,730	-	-

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27. MATURITY PROFILE OF ASSETS, LIABILITIES AND EQUITY (CONTINUED)

As at 31 December 2006	Less than 1 year	1 to 5 Years	Above 5 Years	Total
Assets				
Cash and bank	5,082	-	-	5,082
Call deposits	517	-	-	517
Placements with banks	25,399	-	-	25,399
Trading securities	10,806	1,205	-	12,011
Available-for-sale securities	476	400	10,493	11,369
Furniture and equipment	-	140	-	140
Fees receivable	204	-	-	204
Other assets	2,397	-	-	2,397
Total assets	44,881	1,745	10,493	57,119
Liabilities				
Bank overdrafts	58	-	-	58
Short term borrowings	1,693	-	-	1,693
Customer accounts	25,660	-	-	25,660
Other liabilities	1,039	-	-	1,039
Total liabilities	28,450	-	-	28,450
Equity	-	-	28,669	28,669
Total liabilities and equity	28,430	-	28,669	57,119
Liquidity gap	16,431	1,745	(18,176)	-
Cumulative liquidity gap	16,431	18,176	-	-

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28. ACCOUNTING CLASSIFICATION AND FAIR VALUES

The table below sets out the classification of each class of financial assets and liabilities, and their fair values.

31 December 2007	**Fair value through profit or loss – held for trading**	**Available for sale**	**Amortised cost**	**Total carrying value**	**Fair value**
Cash and cash equivalents	-	-	63,174	63,174	63,174
Investments at fair value through profit or loss	20,392	-	-	20,392	20,392
Available-for-sale investments	-	13,776	-	13,776	13,776
Fees receivable	-	-	5,096	5,096	5,096
Other assets	-	-	1,843	1,843	1,843
	20,392	**13,776**	**70,113**	**104,281**	**104,281**
Short-term borrowings	-	-	566	566	566
Payables to customers	-	-	53,661	53,661	53,661
Other liabilities	-	-	7,536	7,536	7,536
	-	**-**	**61,763**	**61,763**	**61,763**

31 December 2006	Fair value through profit or loss – held for trading	Available for sale	Amortised cost	Total carrying value	Fair value
Cash and cash equivalents	-	-	30,940	30,940	30,940
Investments at fair value through profit or loss	12,011	-	-	12,011	12,011
Available-for-sale investments	-	11,369	-	11,369	11,369
Fees receivable	-	-	204	204	204
Other assets	-	-	2,352	2,352	2,352
	12,011	11,369	33,496	56,876	56,876
Short-term borrowings	-	-	1,693	1,693	1,693
Payables to customers	-	-	25,660	25,660	25,660
Other liabilities	-	-	970	970	970
	-	-	28,323	28,323	28,323

Included in AFS category are investments amounting to BD 364 (2006 : BD 377) that are carried at cost in the absence of a reliable measure of fair value.

29. GROUP INFORMATION

The Group comprises of Securities and Investment Company BSC (c) (the Parent) and the following wholly owned subsidiaries:

Subsidiary	Capital BD '000	Date of incorporation	Activity
SICO Funds Company BSC (c)	50	21 March 1998	Umbrella company for SICO mutual funds
SICO Funds Services Company BSC (c)	400	29 December 2004	Custody and administration services
SICO Funds Company II BSC (c)	1	26 September 2005	Umbrella company for SICO mutual funds
SICO Funds Company III BSC (c)	1	18 January 2006	Umbrella company for SICO mutual funds

The following is a summary of the parent's financial statements

Parent balance sheet as at 31 December 2007

As at 31 December	**2007**	2006
	BD '000	BD '000
Assets		
Cash and bank	13,864	4,713
Call deposits	850	516
Placements with banks	46,597	25,070
Investments at fair value through profit or loss	20,392	12,011
Available-for-sale investments	13,776	11,369
Investment in subsidiaries	452	452
Furniture and equipment	124	133
Fees receivable	4,934	204
Other assets	2,252	2,272
Total assets	**103,241**	56,740
Liabilities		
Bank overdraft	7	58
Short term borrowings	566	1,693
Customer accounts	53,661	25,660
Other liabilities	7,172	726
Total liabilities	**61,406**	28,137
Equity		
Share capital	13,921	13,910
Statutory reserve	2,216	1,807
General reserve	2,063	1,666
Available-for-sale securities fair value reserve	3,384	648
Retained earnings	20,251	10,572
Total equity	**41,835**	28,603
Total liabilities and equity	**103,241**	56,740

29. GROUP INFORMATION (CONTINUED)

Parent income statement for the year ended 31 December 2007

Year ended 31 December	**2007**	2006
	BD ‘000	BD ‘000
Income		
Interest income	1,534	1,222
Interest expense	(659)	(508)
Net interest income	**875**	714
Net investment income	5,944	2,093
Fee and commission income	6,285	1,355
Brokerage and other income	2,513	2,207
Total income	**15,617**	6,369
Operating expenses		
Staff and related expenses	3,027	1,786
General, administrative and other operating expenses	792	550
Depreciation	87	64
Total expenses	**3,906**	2,400
Net income for the year	**11,711**	3,969

30. CAPITAL ADEQUACY

The capital adequacy ratio has been calculated in accordance with the guidelines of the Central Bank of Bahrain (CBB), incorporating both credit risk and market risk.

The market risk is computed as per the guidelines of the CBB. The measure of market risk so computed is multiplied by 12.5, the reciprocal of the 8 percent minimum capital ratio, to arrive at the market risk weighted exposure. The market risk-weighted assets are then added to the credit risk-weighted assets to arrive at the Group's total risk-weighted exposure, which is used for the purpose of computing the capital adequacy ratio.

Details of the Group's calculations as at 31 December are shown below.

Based on year end balances

	2007	2006
	BD '000	BD '000
Tier 1 Capital		
Equity (adjusted based on regulatory guidelines relating to IAS 39)	38,273	22,997
Tier 2 Capital	1,726	4,805
Total capital base (tier 1 + tier 2)	**39,999**	27,802
Credit risk-weighted assets	33,853	19,993
Market risk-weighted assets	72,313	69,788
Total risk-weighted assets	**106,166**	89,781
Capital adequacy ratio	**37.68**	30.97

Based on full year average balances

	2007	2006
	BD '000	BD '000
Tier 1 Capital		
Equity (adjusted based on regulatory guidelines relating to IAS 39)	28,273	22,852
Tier 2 Capital	3,388	3,815
Total capital base (tier 1 + tier 2)	**31,661**	26,667
Credit risk-weighted assets	24,376	21,208
Market risk-weighted assets	64,644	50,051
Total risk-weighted assets	**89,020**	71,259
Capital adequacy ratio	**35.57**	37.42

31. NEW INTERNATIONAL FINANCIAL REPORTING STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

During the year the following new/amended IFRS's and interpretations have been issued which are not yet mandatory for adoption by the Group:

- IAS 1 "Presentation of Financial Instruments": effective for financial periods beginning on or after 1 January 2009.
- IAS 23 "Borrowing Costs": effective for financial periods beginning on or after 1 January 2009.
- IFRS 8 "Operating Segments": effective for financial periods beginning on or after 1 January 2009.
- IFRIC 11 "IFRS 2 – Group and Treasury Share Transactions": effective for financial periods beginning on or after 1 March 2007.

The adoption of these standards and interpretations are not expected to have any material impact on the consolidated balance sheet and income statement.

32. COMPARATIVE FIGURES

Comparative figures have been reclassified to conform to the current year's presentation. Such reclassification has not affected the reported net profit, net assets or equity.