



KUWAIT FINANCE HOUSE - BAHRAIN B.S.C (C)

ANNUAL REPORT 2005





HH Shaikh Khalifa bin
Salman Al Khalifa
Prime Minister



HM King Hamad bin
Isa Al Khalifa
King of Bahrain



HH Shaikh Salman bin
Hamad Al Khalifa
Crown Prince and
Commander-in-Chief
of the Bahrain
Defence Force

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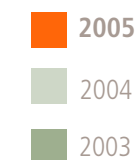
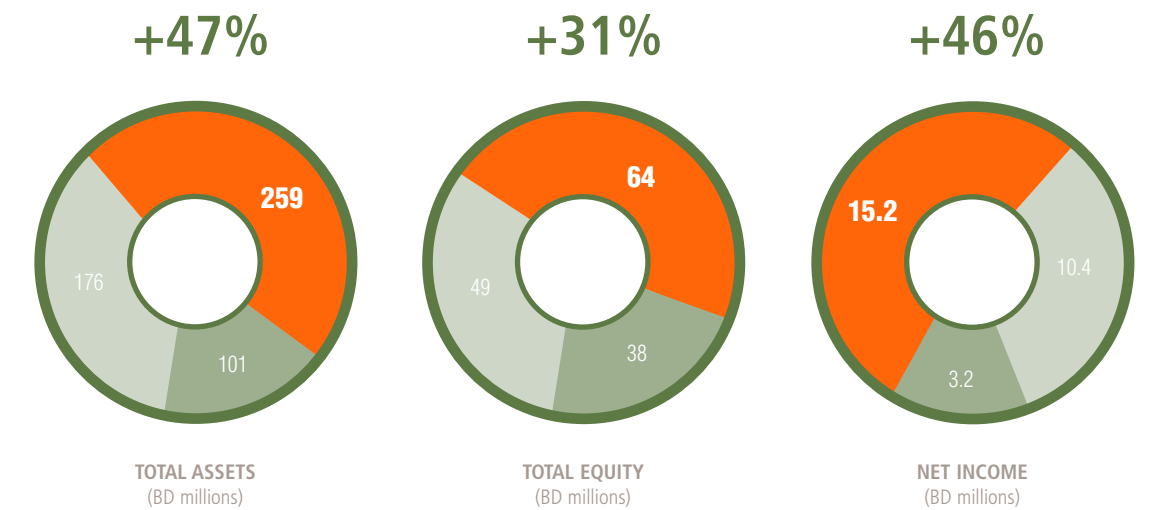
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Financial Highlights

With the aim of creating assets for its stakeholders and supporting growth in the economies in which it operates and invests, it is the mission of Kuwait Finance House - Bahrain to deliver excellence and innovation in Islamic commercial and investment banking.

Reflecting its unwavering commitment to Islamic values and its ongoing efforts to promote the concept of Islamic banking worldwide, this is achieved through long-term participation in the local and regional markets and the development and introduction of a broad range of unique products and services that are in perfect harmony with Shari'a principles.

These efforts are supported by a forward-thinking strategy and implemented by a dedicated management team and a highly skilled staff whose devotion to quality, service and integrity are reflected in every aspect of the bank's operations and its efforts on behalf of its stakeholders.



	2005 (BD thousands)	2004 (BD thousands)	2003 (BD thousands)
Net Income	15,166	10,392	3,245
Total Assets	258,865	176,155	100,947
Total Equity	63,802	48,756	38,440
Return on Average Equity (%)	26.9%	23.8%	8.8%



We continue to operate with an unwavering focus on channelling our efforts and our resources towards **Investing in Growth**

Dear Stakeholders,

It is with great pleasure that I present to you the 2005 annual report of Kuwait Finance House–Bahrain at the conclusion of what has been another year marked by significant progress and strengthened performance.

By every measure, we have continued to make great strides in further enhancing our operations and the opportunities and results we are able to deliver to our customers, investors and stakeholders.

Our success and the great achievements of 2005, continue to be rooted in two key principles. First, that KFH-Bahrain, like its parent Kuwait Finance House, strives on an ongoing basis to take a leadership role in the further development of the Islamic banking industry by remaining at the forefront of innovation in Islamic commercial, corporate and investment banking.

Second, that we continue to operate with an unwavering focus on channelling our efforts and our resources towards investing in growth, both that of the Bank including our employees and operational infrastructure as well as in the infrastructure, economies and human development of the markets in which we operate.

We believe that these principles have served us well since our establishment and, that over the past year, our dedication to building our business along these lines has yielded positive results.

During the year, we achieved further growth across KFH-Bahrain, expanded our offering of high-quality products and services and strengthened our ability to provide investors with compelling opportunities. This included access to new asset management products, investments in major local

and regional development projects in addition to compelling international opportunities that have met the Bank's stringent investment criteria and its ongoing commitment to take Islamic banking to new frontiers.

These opportunities were well diversified, covering both a number of geographic regions and industry sectors such as downstream industrial development, science and technology and real estate. However, when looking at the Bank's investment offering, there remains one unified theme, KFH-Bahrain invariably introduces products and seeks investments with a particular emphasis on adding value, driving growth and supporting sustainable development.

Moreover, the ongoing success of our existing investment portfolio continues to reflect positively on the Bank and our performance during the year. Our diverse portfolio of corporate and private equity investments continued to perform in line with our expectations. This underscores the strength of our investment strategy as well as the superior management support and resources KFH-Bahrain commits to investee companies, which we have helped to grow and maximise their potential.

This is also the case for each of our own business lines, where we have worked diligently over the past year to ensure progress and strengthened results. We are proud to report that our efforts have been successful with our investment banking, corporate finance and retail banking divisions performing exceptionally well in 2005.

For the year, direct deposits from customers increased by **152%** from BD51.6 million in 2004 to **BD130.2 million in 2005**. Strengthened performance was also highlighted with the Bank reporting an increase of **46% in net profits**, which reached **BD15.2 million** at year end versus BD10.4 million in 2004. This represents a **27% return on equity** for 2005 versus a **24%** return on equity in the previous year. Assets also

increased by **47% to BD259 million** in 2005 versus BD176 million in 2004. Total operating income for 2005 was **BD34.6 million** compared with BD20.3 million in the prior year, representing growth of **71%**.

These results serve to underscore the strong internal progress made by the Bank particularly in the areas of risk management, enhanced corporate governance and ongoing efforts to ensure the highest levels of transparency in our reporting standards and methods for the distribution of profits to our customers.

In addition, our performance was further supported by the sound macroeconomic fundamentals of the regional economies, which effectively helped to drive the gains made by the Bank in 2005.

Characterised by unprecedented levels of liquidity, investor confidence and local and regional opportunities, the economies across the GCC registered significant growth during 2005. High oil prices also continued at unparalleled levels, resulting in revenue windfalls across the oil producing nations of the GCC, and further spurring spending and investments in regional projects aimed at achieving diversification and further economic development.

Nowhere have the benefits of these dynamics been more pronounced than in Bahrain, where the past year has witnessed remarkable growth and the further rapid introduction of major new projects. We believe these strong economic fundamentals and positive economic gains will continue unabated.

With this in mind, as we go forward in 2006, we maintain our commitment to **Investing in Growth** in line with the vast opportunities that exist in our markets of operation on a regional and global level and will continue to invest our resources in the strengthening of our financial position and operating platform.

In the year ahead, we will look to further enhance the capital base of the Bank and will work to deliver even stronger levels of profitability. This will be achieved through the implementation of a prudent investment strategy and solid risk management, in addition to the cultivation of compelling long-term investment opportunities.

Additionally, we will continue to invest our time and resources in creating products and services that provide sound financial benefits to our customers as well as those that support the ongoing development of the economies of this region.

We see particularly strong prospects in Bahrain, where we have already made significant investments in key growth projects. In 2006, we intend to vigorously pursue further opportunities to identify and participate in projects of social and economic consequence, which are capable of upgrading the living standards of citizens, facilitating knowledge transfer and human development and generating employment and inward investment opportunities.

On behalf of the Board of Directors and our Bank, I would like to extend our gratitude to His Majesty King Hamad bin Isa Al Khalifa, the King of Bahrain, His Highness Shaikh Khalifa bin Salman Al Khalifa, the Prime Minister and His Highness Shaikh Salman bin Hamad Al Khalifa, the Crown Prince and Commander-in-Chief of the Bahrain Defence Force. Their vision and continued efforts to drive growth in Bahrain and regional advancement provide the foundation for our ongoing activities and commitment to this market.

The Bahrain Monetary Agency (BMA) also continues to play a vital role in supporting the mission of KFH-Bahrain and the Islamic banking industry. We extend our thanks for their contributions to the creation of a sound regulatory and investment climate within the Kingdom. We also would like to extend our thanks to the Ministry of Commerce and Ministry of Industry for their valued contribution in supporting the development of commercial and industrial sectors in the Kingdom.

In conclusion, I would also like to extend our sincere appreciation to our employees, customers and numerous partners, all of whom we view as stakeholders in the success of our Bank and the strong future that lies in store in 2006 and beyond.

Yours sincerely,

Bader Abdul Muhsen Al-Mukhaizeem
Chairman and Managing Director



Throughout 2005, the Bank continued to **strive for excellence** and to ensure that our products, services and investments were at the forefront of industry innovation.

Dear Stakeholders,

We are pleased to report another year of enhanced results and strengthened operations at KFH-Bahrain. During 2005, we maintained a singular focus on Investing in Growth.

We are confident that our investments not only supported the significant progress that we have made over the past year but that these investments have set the stage for KFH-Bahrain to continue to meet its objectives and fulfil its obligations to our customers, partners, shareholders and to our community.

Throughout 2005, the Bank continued to strive for excellence and to ensure that our products, services and investments were at the forefront of industry innovation.

During the year, we invested significantly in ensuring that our foundations were strong and that our resources were being effectively channelled towards the reinforcement and growth of critical areas.

From an operational standpoint, the Bank made significant progress. We invested substantial time, effort and capital into achieving growth. We were successful in extending our product and service offering, growing our branch network, expanding our already highly skilled and motivated management team, supporting the professional and personal growth of our employee base and strengthening the overall means, methods and systems that we employ across the Bank.

This has provided a solid base for further growth and for the enhanced performance that was delivered by each of our business lines during the year including our Islamic commercial, corporate and investment banking divisions.

In addition, there were also significant enhancements in the treasury where we focused in 2005 on improving the deal process and systems, the maturity profile of KFH-Bahrain's liabilities and reporting and projection and cash flow planning within the Bank. Furthermore, we secured new short and medium-term credit lines for the Bank, took steps to ensure there were competitive sources of funding in place for the various business units and began to diversify our short-term assets by investing in sovereign sukuk.

We will continue these efforts in 2006 and focus on developing short-term money market and capital market products, improving long-term funding and diversifying our sources of revenues from short-term assets.

Additional enhancements were also made in risk management and information technology, where we made further investments and added resources during 2005. We believe that these areas act as the Bank's backbone and significantly enhance our ability to deliver strong results to our customers, investors and shareholders.

KFH-Bahrain remains very cognisant that in the current competitive investment environment, we must, at all times, leverage our resources effectively and manage our risk if we are to continue to provide our customers with superior products and services, opportunities and, ultimately, the strong returns on investment that we have been able to deliver since the establishment of the Bank.

As we invested in the growth and the further strengthening of our own operations, we were simultaneously focused on investing in the growth of our industry and the local and regional economies.

We pursued this objective in a number of ways. Primarily, we sought out opportunities to invest in and support entrepreneurial regional companies looking for the necessary funding to meet their potential; identifying international investment opportunities that could provide further exposure for our industry and or facilitate knowledge transfer to the region; and, importantly, through our origination and participation in major industrial, science and technology and real-estate development projects.

During the year, we worked closely with the Bahrain Economic Development Board (EDB) to identify key infrastructure, investment and social needs of the economy and our community and, together, targeted a number of areas in which KFH-Bahrain could support efforts to drive inward investment, job creation and the overall enhancement of the Kingdom's economy.

In this spirit, we sponsored a number of major conferences in Bahrain focused on industry and driving innovation in the Arab World including the 3rd Forum on Investing in Technology, in conjunction with the Arab Science & Technology Foundation. Furthermore, we announced our intention to spearhead a number of projects in Bahrain, which will drive diversification and downstream development. These included the introduction of preliminary plans for the creation of a Science & Technology Park, a first in the Middle East region, as well as an Industrial Oasis at the newly established Hidd Industrial Zone, which will help to encourage the further expansion of this important sector in Bahrain.

We are excited by the prospects of these projects and the opportunities they provide for the Bank, our customers and the greater good of the

markets in which we operate. At the same time, we are also delighted by the ongoing progress that has been made over the past year by our existing and fast-expanding portfolio of investments.

We are particularly pleased by the enormous developments that have been made at the US\$3 billion Durrat Al Bahrain project, the Kingdom's largest planned residential, commercial and resort city, in which we are a 50% shareholder. Villas offered in Phase I and II sales, to both locals and expatriates, have already been sold out and work on the development has literally transformed the map of Bahrain as the 20km² site and world-class design of the island paradise take shape. We have great confidence that this project will be a significant driver to the economic growth of Bahrain and will create extensive opportunities for the local and regional communities.

As we go forward, we are determined to continue our efforts to invest in the growth of our Bank, our employees and our community and economies. We believe strongly in our social and corporate responsibilities and will continue to act and invest according to our ideals, the highest standards and our great confidence in this region, our industry and our people.

The successes and progress of the past year have provided us the foundation we need to continue our growth and efforts to remain at the forefront of industry advancement. Furthermore, we believe that we are better positioned than ever to make significant contributions and deliver even stronger levels of innovation, performance and results across our organisation.

In conclusion, we would like to extend our deepest gratitude to the Bahrain Monetary Agency (BMA), the growing number of industry standards setting organisations, the Bahrain Economic Development Board (EDB) and

We are particularly pleased by the developments that have been made at the **US \$3 billion Durrat Al Bahrain** project, the Kingdom's largest planned residential, commercial and resort city.

the Ministry of Commerce and Industry. Together, these institutions have provided us with the necessary frameworks, support and vision to advance and prosper over the past year and well into the future.

I would also like to say thank you to all of our stakeholders including the employees of the Bank, our partners and our shareholders for their continued cooperation in our drive to achieve excellence. Together we have created an exceptional bank with immense potential and the ability to deliver exceptional results and value. We look forward to updating you on the progress we make in each of these areas during 2006.

Yours sincerely,

Abdulhakeem Alkhayyat
General Manager

Board of Directors



Management Team

We continued to add significant resources and **talented** investment and customer-facing **professionals** to our already dynamic team.



Abdullahakeem Alkhayat
General Manager



Fuad Taqi
Assistant General Manager



Abdul Razak Jawahery
Investment Placement



Paul Mercer
Legal Advisor



Waleed Rashdan
Risk Management



Jalal Haji
Operations



Jameel Alkhaja
Credit



Khaled Rafia
Consumer Finance



Lilian Le Falther
Treasury



Mohammed Arbouna
Shari'a Adviser



Mohammed Hamad
Investment



Osama Alkhaja
Venture Capital



Ahmed Saeed
Investment



Salah Al Majthoub
Information Technology



Sattam Al Gosaibi
Corporate Finance



Hisham Al Moayyed
Real-Estate



Waleed Ahmadi
Human Resources



Yousef Alhammadi
Financial Control

KFH-Bahrain's investments in growth touched on every aspect of the Bank's operations, **significantly strengthening** its ability to execute and meet strong demand on the part of its customers and investors for compelling products, investment **opportunities** and rates of return.

With a strategic focus on investing in growth, KFH-Bahrain made substantial progress in 2005. The Bank delivered enhanced results across its Islamic commercial and investing banking divisions and further reinforced its position as a leader and champion of innovation, excellence and advancement for the Islamic banking industry and the economies of the region.

KFH-Bahrain's investments in growth touched on every aspect of the Bank's operations, significantly strengthening its ability to execute and meet strong demand on the part of its customers and investors for compelling products, investment opportunities and rates of return. Additionally, the Bank's strategy to channel its resources towards growth also extended to the investments made by the Bank during 2005 in support of companies and projects that help to drive further development and economic diversification in Bahrain and in neighbouring and international markets.

This philosophy and KFH-Bahrain's commitment to investing in growth has ensured the creation of an even stronger platform for the Bank, one upon which we can further grow our operations and continue to enhance our ability to add value for the benefit of stakeholders, our industry and the markets in which we operate.

RISK MANAGEMENT

During 2005, the enhancement of risk management policies and their practical implementation remained a key focus for KFH-Bahrain. Specifically, throughout the year, the Bank looked closely at the processes currently in place, assessing their effectiveness and our ongoing ability to properly manage the Bank's risk management activities across all key

markets of operation. In doing so, we reviewed plans and procedures as they pertained to credit risk, equity and investment risk, market and liquidity risk, operational risk and Shari'a and technology risk.

In effectively reviewing and analysing each of these areas, the Bank adopted plans in 2005 to introduce the latest, state-of-the-art risk management systems with a particular emphasis on measuring credit, operational and market risk. We are currently in the processes of looking at a number of options in order to select the most useful and scalable systems and those that will allow us to maximise transparency and reporting standards.

Already KFH-Bahrain provides strong disclosure and regularly filed financial statements prepared in accordance with the International Financial Reporting Standards (IFRS).

In this extremely competitive environment, KFH-Bahrain believes that investors and shareholders are seeking from us the highest levels of transparency and financial information and safeguards.

We are committed to ensuring that this is what we are delivering at all times. Ultimately, superior risk management is the backbone of the Bank and its ability to continue its ongoing growth and success.

With this in mind, we are taking additional steps at the Board level to ensure even further enhancements. We believe that stronger Board involvement will provide for an even more robust risk management function and ensure that the risk appetite of the Board are being effectively set and implemented across all areas of the Bank's operations.



During the year, KFH-Bahrain established plans to launch Risk Committees to supervise the overall activities of risk management. We believe this will serve to better define the Bank's risk management policies, but further serve as the basis for the effective pricing of products and investments for the benefit and security of all stakeholders.

In addition to these inward looking measures, the Bank also continued to focus its efforts on ensuring that we were moving forward with optimal adoption of Basel II and Bahrain Monetary Agency (BMA) guidelines and directives. KFH-Bahrain, in 2005, took part in a BMA Task Force, which has been established to address a number of issues including Consolidation & Capital deduction, Standardised Approaches to Credit & Operational Risk, Foundation IRB Approaches to Credit Risk. The first task force, consisting of both Islamic and conventional banks, finalised its draft report of its finding during the year, which are currently under consideration with the BMA. KFH-Bahrain also participated in a special task force established by the BMA to discuss and comment on the IFSB paper on Capital Adequacy for Islamic Financial Institutions. The Task Force finalised and sent its comments to the BMA for its consideration.

KFH-Bahrain, in line with its dedication to industry advancement across all areas, is constantly working closely with the BMA and other institutions to ensure the effective interpretation and adoption of key risk management directives and regulations that can provide greater standards and safeguards for shareholders, investors and financial intuitions themselves.

CONSUMER BANKING & FINANCE

KFH-Bahrain's consumer banking and finance division continued to make great strides and report strong performance as a result of ongoing investments in growth and an unwavering focus on meeting the needs and expectations of our customers. During the year, we continued to grow

our product and service offering, our teams of dedicated client facing and customer service professionals, our branch network and our back-end resources and infrastructure in order to achieve optimal efficiency.

Our investments and our growth in each of these areas have yielded positive results for the Bank and our customers. As a result of our expanded capabilities, we have continued to maintain the confidence of our customer base and have successfully added new customers during 2005. This is best reflected by an increase in customer deposits, which reached BD130.2 million for the year, a gain of 152% over 2004.

At the same time, we believe that the investments we have made in the Bank and its further development have not simply helped to enhance our position and growth. Rather, we are confident that these investments have also positively impacted the financial growth and long-term financial success of our loyal and rapidly expanding customer base.

Investing in Strength of Service:

During 2005, we continued to add significant resources and talented investment and customer-facing professionals to our already dynamic team so as to continually upgrade the level of advice, personal attention and service we are providing to all of our clients.

Of particular significance was the full roll out of our Priority Banking unit. Staffed by seasoned investment professionals with significant industry experience, this division is dedicated to overseeing the commercial and investment banking interests of a growing number of high net-worth and ultrahigh net-worth clients and investors.

The exceptional quality of service provided by this team as well as the attractive array of products and investment opportunities they have been

During the year, we extended some **BD 71.4 million in credit facilities** in support of these companies, an increase of 100 percent since 2004.

able to offer clients is reflected through the outstanding results they have been able to deliver in just one year's time. For 2005, **we saw deposits reach over BD130.2 million.**

Furthermore, we also continued to expand our Ladies Banking operations, providing enhanced service and support for this increasingly important customer segment. The financial needs of female banking customers are broad ranging from personal banking and finance to the need for the provision of corporate services. Managed by an industry-leading team, our ladies banking division now offers a full service option for this key customer group and ensures that all of their financial requirements are being effectively met and managed.

Investing in the Access & Convenience:

Continuing to put in place the right strategy to enhance access and convenience for our customers was also a key focus for the Bank in 2005. Primarily, we looked at opportunities to grow our branch network and provide our customers with more convenience in terms of their ability to take advantage of our broad product and service offering.

During the year, we not only opened a new branch in Riffa, we also established five new ATM sites including those located at the Bahrain International Airport, Romaihi Petrol Station, Sakhir as well as the BDF Petrol Station and Supermarket. These are all fast developing areas and will provide our customers with greater access to our products and services. Furthermore, during the year, we evaluated other important and fast growing locations in Bahrain and are set to open additional branches and offsite ATMs in the next two years in strategic locations.

Furthermore, in an effort to enhance convenience and provide greater access to our services and information, we continued to strengthen key

customer service features such as the operation of our information and customer-care systems. These include the enhancement of our Interactive Voice Response (IVR) telebanking system for 24 hour automated service, our call centre and the development during the year of a new website and web banking capability.

Investing in Product Development:

Ongoing investment in the development and enhancement of our products and services remain critical to the success of our business and our ability to meet the evolving needs of our customers. In 2005, we continued to assess market demands and looked to effectively strengthen our product range accordingly.

During the year, we introduced a number of new products including the highly successful Landmark One product, an innovative asset management product. This represented the first in a series of Restricted Mudharaba Investment Accounts being developed by KFH-Bahrain, and was geared specifically towards investment in the local and regional real-estate market.

Phase 1 and 2 offerings of Landmark One were met with strong investor demand and quickly exceeded investment targets. Of particular significance is that this product provides maximum flexibility and investor access through minimum investment levels as low as only BD1,000, expected rates of return exceeding 6 percent per annum, a periodical cash yield and a fluctuating rate of return with early-exit options.

Furthermore, we made enhancements to our newly established Ijara Card in order to allow an even greater number of customers the ability to acquire durable goods on an Islamically acceptable "lease to own" basis. We took the necessary steps to further automate and refine the card and its benefits and are pleased to be able to offer hundreds of families in

CONSUMER BANKING & FINANCE CONTINUED

Bahrain, during 2006, the opportunity to purchase products they may otherwise not be able to own. Additionally, we have looked closely at the introduction of other new card products and expect to launch a Visa Card in 2006.

With regard to financing, we continued to lead the market in terms of the duration and flexibility we provide to our customers. Having been the first bank in Bahrain to introduce a 20 year real-estate finance product, we continue to focus on helping Bahrainis and expatriates of all socio-economic levels become homeowners. In addition to offering financing for projects such as Durrat Al Bahrain and Meena 7 apartments in Amwaj Islands in which we are shareholders, we are also active in providing financing for our customers in numerous other real-estate developments and housing projects.

With regard to auto financing, we similarly continue to work hard to meet the needs of our customers. We are poised to launch a new concept in car financing in Bahrain during the second half of 2006 by partnering with well known car dealers and showroom operators in order to give our customers greater choice.

Through investments in these areas and the developments that have followed, we have reinforced our position in the market and have continued to demonstrate our commitment to developing and maintaining long-term relationships with our customers.

We believe our Bank to be a part of the community in which we operate and all of our investments are made with the intent of both strengthening and growing our operations whilst simultaneously helping our clients and community effectively invest in growth and a strong financial future.

CORPORATE FINANCE

Investing in growth has always been the core focus of our corporate finance division with 2005 being no exception. During the year, the Bank continued to take the necessary steps to further expand our activities, our participation in the market and our position as a leading proponent of economic development.

Specifically, during the year, we looked aggressively at enhancing our support for an increased number of fast-growing businesses, ranging from small and medium-sized companies to large corporates, in addition to backing key projects in Bahrain and across the region.

For our corporate customers this support consisted of advice and financial resources including real-estate financing, project financing, working capital financing and trade financing through the provision of Import/Export Letters of Credit, Letters of Guarantee and Documentary Collections.

Companies with whom we work are active in multiple industry sectors, however, they share one common criteria. They are companies that add value to the local and regional economies and communities in which they operate. During the year, we extended some BD71.4 million in credit facilities in support of these companies, an increase of 100 percent since 2004.

These facilities and the service provided by our growing corporate finance team were offered to customers in our central branches and also through our presence in the Bahrain Investors' Centre (BIC), which we established during 2004. We are still the only Islamic bank operating at this facility, which was established with the aim of helping to facilitate efforts on the part of local and international companies to invest in growth – both that of their own businesses as well as in the economy of Bahrain.



PROJECT DEVELOPMENT

During the year, KFH-Bahrain also announced initial plans for the development of several new large scale projects in Bahrain that will support economic diversification, downstream development, knowledge transfer and training as well as job creation.

The first of such endeavours was the KFH Industrial Oasis, a first of its kind project in the Kingdom, aimed at driving ongoing expansion in the industrial sector and meeting fast growing demand for industrial based real-estate projects in Bahrain. KFH Industrial Oasis will comprise 168,000m² of land to be located within the Bahrain International Investment Park (BIIP), a newly established area located in the Hidd Industrial Zone, which focuses on attracting regional and international companies active in the areas of technology, manufacturing and the services sectors.

At full capacity, it is planned that the Oasis could well bring in investments upwards of US\$200 million into the Bahrain economy and it is envisaged that it will help to create more than 2,000 industrial related jobs. In addition to funding the development of the necessary infrastructure for the establishment of the Industrial Oasis, KFH-Bahrain would intend to further provide access to financing options and capital for potential tenants in order to facilitate the development of the industrial zone and provide needed support to start-up companies with compelling business plans and the ability to add value to the local economy.

Another similar project was announced by the Bank at the KFH sponsored 3rd Forum on "Investing in Technology", an event initiated by the Arab Science & Technology Foundation for building momentum among the private and public sectors to focus greater attention on supporting innovative Arab technology companies, start-ups and entrepreneurs as well as scholars and scientists.

To underscore the paramount importance of science and technology of the region to compete on a global scale, as well as KFH-Bahrain's dedication to invest in growth, the Bank unveiled at the Forum initial plans for helping to position Bahrain as a leading regional science and technology hub. In doing so, KFH-Bahrain provided details of an initial concept and plan for furthering this objective and announced efforts that it had undertaken during 2005 to work towards the fulfilment of this goal. This included signing a Memorandum of Understanding with Europe's leading technology park operator (Sophia Antipolis Technology Park) which will act as KFH-Bahrain's partner in completing due diligence on the project and subsequent plans for establishing the region's first technology incubator.

During the year, the Bank also announced its participation in the development of the Hidd-based National Institute for Industrial Training, the first private vocational training institute to be established in Bahrain. The establishment of this center, which is set to open by the end of 2006, will complement KFH-Bahrain's and the government's ongoing efforts to support job creation by giving locals as well as those around the region the opportunity to develop their relevant skills to either enter into or advance in the industrial sector whilst at the same time supporting further economic diversification.

Other key projects, for which the Bank has provided funding, also continued to perform according to plan during 2005. These included the Bahrain World Trade Center project, which consists of two towers, each 50 floors, which will be used as prime office, commercial and retail space in the heart of Manama in addition to the Meena 7 project, located on the Amwaj island resort in Bahrain, in which KFH-Bahrain is a 60 percent shareholder.

As we move forward in 2006, we will remain focused on **supporting the growth** of these and every company and project in our investment portfolio.

We have embarked upon a number of very compelling projects in 2005, which we will work hard to bring to fruition in the year ahead. We also remain committed to seeking out even further opportunities to invest in the growth of businesses in Bahrain as well as key development projects that drive growth and add value both in Bahrain and across the region.

INVESTMENT ACTIVITIES

The Bank's investment activities during 2005 were aimed at generating opportunities of growth for the benefit of all of our stakeholders.

During the year, we continued to evaluate a significant number of potentially meaningful opportunities across multiple industry sectors and geographic locations, opting to take part in a number of promising transactions and projects.

These ranged from investments in local real-estate ventures to private equity placements on an international basis as well as funding for the establishment of Shari'a compliant start-up businesses and existing companies with significant growth potential.

In undertaking investments in each of these areas, KFH-Bahrain relied heavily on the expertise and know-how of its strong investment professionals as well as its extensive network of world class consulting partners that play an important role in deal origination and evaluation to ensure that each of our investments are innovatively structured, diversify our portfolio and can ultimately deliver superior risk-adjusted returns to our investors.

Furthermore, with all of the investments we undertake, we believe that a key principle of investing in growth is to play a key role in ensuring the success of each of our investments' post acquisition.

We view the companies and projects in which we invest as partners and work alongside each of them to make certain that we are providing optimal support, resources and management time in order to foster growth and maximise potential returns. We believe at the heart of Islamic banking and finance is shared investment, shared risk and shared reward and we ensure that this is the case on an ongoing basis in each of the investments we undertake.

During 2005, we continued to maintain this philosophy both through the new transactions we completed but further through our efforts to continue to effectively monitor and ensure the enhanced performance of our existing investments through the implementation of improved capital structures, management reorganisation, improvements to corporate governance and board restructuring, strategic financial and management support and operational restructuring.

Key new investments made during the year included our acquisition of a significant shareholding in April 2005, in Astron Clinica, whose vision is to revolutionise skin imaging and help dermatologist, general practitioners and plastic surgeons to diagnose, analyse, and monitor skin health including Melanoma, a deadly and fast spreading skin cancer. Astron Clinica has developed and launched a technology that provides a reliable diagnostic tool in a portable, low cost format that allows the physician to examine the surface and deeper layers of the skin. There is significant demand for this technology worldwide and we will be working together with Astron Clinica's strong management team in the years ahead to help the company reach its potential whilst transferring a broad range of health benefits to people across the globe.

The second investment announced was Ishbiliya Village, which aims to provide the highest standard of modern accommodation with initial plans envisaging the establishment of approximately 300 villas and 100

apartments of varying sizes and price. Of particular importance is the project's goal to meet the strong need and absence of mid-market housing in Bahrain. This is an important mission for KFH-Bahrain.

We are always seeking ways to invest in the future of the local market as well as the future of members of this community. We believe this project is a noteworthy one with broad ranging benefits for the Bank and its investors, the economy and potential homeowners, who may not have had the opportunity to date to purchase well priced, good value homes.

Current real-estate investments also continue to move forward at a rapid pace. KFH Bahrain's investment in Durrat Al Bahrain remains a critical focus for the Bank and the past year has shown remarkable progress. At the end of 2005, land reclamation has moved to its final stages and work on Phase 1 and 2 villas which were sold out upon offering to the public, is set to start in early 2006. Both Bahraini nationals and expatriates have expressed strong demand for property in Durrat Al Bahrain, which once complete will be Bahrain's largest mixed residential, commercial and resort destination, equalling Bahrain's capital city of Manama in size. This project is a true milestone for Bahrain and its completion will see massive opportunities for inward investment, job creation and further economic diversification in a number of key areas including tourism.

Our diverse portfolio of private equity investments also continued to perform according to expectations. We were particularly pleased with developments made at US-based Liberty Aerospace Inc., a privately designer and manufacturer of single-engine piston powered aircrafts, in which we acquired a majority shareholding in 2004. Further, progress was also seen in other investee companies. These include companies in the telecommunications and technology sectors. For example, Mena Telecom (previously known as Mena Broadband Services (MBS) made significant strides over the past year by effectively capitalising on the liberalisation of Bahrain's telecommunications market.

Similarly, investments made through KFH-Bahrain's New Zealand Australia Private Equity Fund during 2004, in Woosh Wireless, a dynamic and fast growing high speed wireless Broadband Service Provider, and NextWindow, a leading designer and developer of optical imaging technologies in the fields of gesture and touch recognition for the commercial retailer market, also continued to deliver positive performance.

As we move forward in 2006, we will remain focused on supporting the growth of these and every company and project in our investment portfolio. Furthermore, we will continue to seek out investment opportunities that can deliver both growth and value for our Bank, investors and local and regional economies.

We see significant opportunities here in the region as well as in key international markets and are always looking to further diversify our portfolio with compelling new opportunities especially those that drive innovation in our business and the Islamic banking and finance industry overall. We see these opportunities through an open mind, with respect to industry and geographical concentration and with a focus on a healthy risk-return profile. These are goals well worth investing in and we will continue with this as our focus in 2006.





The following is a brief overview of **KFH-Bahrain's investment portfolio** including an update on significant developments with respect to operational and investment activity.

LIBERTY AEROSPACE INC. (LIBERTY)

Liberty AEROSPACE	Country	USA
	Sector	Aerospace
	Year of acquisition	2005
	Group holding*	75%

Liberty Aerospace Inc. (Liberty) entered the general aviation industry through designing, producing, marketing and supporting the Liberty XL2 aircraft. The XL2 is the first new two seat single-engine piston powered aircraft to receive US FAA Part 23 Type Certification in over 30 years.

The XL2 is designed and built to provide a modern, cost-effective alternative for the recreational, pilot training and surveillance markets. Since KFH-Bahrain acquired a majority shareholding in Liberty, several milestones have been achieved. Liberty moved from being a start-up to an actual producing company delivering Federal Aviation Authority certified aircraft to clients. Third party endorsements have been secured from major industry experts and Liberty continues to be featured in specialist aviation trade magazines and journals. The Company also regularly receives invitations to participate in regional air shows, with its most recent appearance being the Dubai Air Show in November 2005.

* Including investor

ALKINDI PHARMACEUTICAL

	Country	Jordan
	Sector	Pharmaceutical
	Year of acquisition	2003
	Group holding	54.8%

AlKindi Pharmaceutical, a public limited shareholding company registered in the Kingdom of Jordan, is a specialised pharmaceutical company for the manufacturing and distribution of human-based Insulin, a range of Intra-venous solutions and Haemodialysis solutions under license from major international pharmaceutical companies.

After the initial investment by KFH-Bahrain, AlKindi went on to across major hurdles in the way to become a successful pharmaceutical company. AlKindi succeeded in registering several products and getting them certified following extensive inspection visits from Ministry of Health officials in Jordan and drug testing.

Those achievements led to the confirmation of the initial belief that KFH-Bahrain had in AlKindi, as resulted in exercising the conversion option on the initial Murabaha facility to become a majority shareholder. As KFH-Bahrain became a shareholder, a management restructuring took place with the appointment of a previous minister of trade as a chairman to the board of directors as well as appointing a CEO who comes with a vast experience in the pharmaceutical industry of more than 25 years.

In the times ahead, AlKindi is equipped to grow into a larger successful specialised drug manufacturer supplying the Arab world with some of its needs of specialised drugs like Insulin.

ASTRON CLINICA



Country	UK
Sector	Pharmaceutical
Year of acquisition	2005
Group holding	39%

Astron Clinica's mission is to revolutionise skin imaging and help dermatologist, general practitioners and plastic surgeons to diagnose, analyse, and monitor skin health. Astron Clinica focuses on two main markets: medical and cosmetics.

The company has developed and launched a technology that provides a reliable diagnostic tool in a portable, low cost format that allows the physician to examine the surface as well as the deeper layers of the skin.

Astron Clinica headquarters are located in Cambridge, UK and has a wholly-owned subsidiary in Australia, with distributors across Canada, Europe, Middle East, Australia and New Zealand.

During 2005, Astron Clinica has been able to penetrate different regions of the world, thus achieving global recognition in the pharmaceutical industry. The company is poised to enhance its immense potential in the cosmetics industry and indeed the company is currently negotiating with a leading cosmetic company as to how its technology may be deployed in the cosmetic sector.

MENA TELECOM



Country	Bahrain
Sector	Telecommunications
Year of acquisition	2003
Group holding	100%

The deregulation of the telecommunications industry in Bahrain has opened up the market, allowing multiple players to offer a wide range of products and services. This new trend has assisted Mena Telecom to obtain 5 different telecommunication licenses from the Telecommunications Regulatory Authority (TRA), which has allowed the company to become involved in a number of activities, including Voice-Over IP (VOIP) and the traditional 2-way satellite business.

Recently, KFH-Bahrain acquired the minority shareholding in the company so it is now a wholly owned subsidiary of KFH-Bahrain. This reflects the bank's confidence in the future prospects of the company.

In 2005, Mena Telecom's focus changed to becoming a full telecommunications company in the Kingdom. Current business includes international calling cards, fixed line for international calls (CPS), fixed line for domestic calls and two-way satellite.





Business Review (continued)

WOOSH - BROADBAND TO GO



Country	New Zealand
Sector	Telecommunications
Year of acquisition	2004
Group holding*	21.1%

Woosh currently provides wireless broadband data and voice services throughout Auckland, Wellington, Christchurch and Southland. The company currently has over 15,000 subscribers for its services. To date, Woosh has experienced increasing demand for its products and services, including demand from areas where Woosh currently does not have network coverage and, therefore, is not able to currently satisfy the demand. Accordingly, Woosh is now embarking on an accelerated site roll-out, in order to expand coverage to the 20 largest cities in New Zealand.

The company has a strong management team comprised of professionals who bring complementary backgrounds and skills to the table. The company is positioned to be a strong and leading player in the telecommunication market in New Zealand having its focus on increased coverage and a carefully thought out merger plan with the smaller players in the market.

* Includes New Zealand Australia Private Equity Fund investment.

CANTERBURY OF NEW ZEALAND



Country	New Zealand
Sector	Sports Wear & Apparel
Year of acquisition	2003
Group holding*	42.3%

Within the rugby arena, Canterbury of New Zealand is recognised globally as the world's leading rugby apparel brand. It is singularly focused on rugby and dominates the rugby apparel market. The brand has strong recognition around the world and is positively associated with the values inherent to rugby.

Since the time KFH-Bahrain acquired a stake in Canterbury, the company underwent a major restructuring of operations. The focus of the company is now shifting toward marketing and sales in the Northern hemisphere specifically Europe and North America, as it is widely believed that the potential there exceeds that of any other region. Additionally, the company started outsourcing production operations to countries like China and this has started to show positive results, which are reflected in the profit margins achieved in 2005.

The company is also moving to enter the casual wear market, by engaging in the production of new lines of rugby-themed casual wear.

* Includes New Zealand Australia Private Equity Fund

RADIUS HEALTH GROUP



Country	New Zealand
Sector	Health Care
Year of acquisition	2004
Group holding*	70.8%

Radius Health Group Limited is a diversified 'health sector investment company' focused around the fast growing primary healthcare business model.

Radius Health Group Limited comprises investments in 19 medical centres, mainly ownership of 11 pharmacies, 500 community based clients (accessing RHGL Medical Alarms and Lifestyle Services) and investments in 9 rest home hospitals. This combination represents a base of the best operators in each of the sectors targeted by Radius Health Group Limited.

Key to the successful development, growth and potential value of Radius Health Group Limited is the senior management team, which represents the most experienced, proven and capable team in the sector.

Currently, Radius Health Group Limited is undergoing expansion through further acquisitions of medical centers, pharmacies and rest homes. The group is rebranding itself to enhance market awareness and corporate value. Since its acquisition by KFH-Bahrain, the company has constantly achieved growth in its top line and earnings.

* Includes New Zealand Australia Private Equity Fund investment

MIRACLE GRAPHICS



Country	Bahrain
Sector	Design & Printing
Year of acquisition	2003
Group holding	70%

Established in 1993 and growing each year, Miracle Graphics encompasses four primary divisions within the visual communications sector; design, publishing, print and digital.

2005 saw much growth and several new opportunities created by the group. The digital division which specializes in the new niche of Digital Asset Management (DAM) now offers high-end server based management of companies digital assets. Their specialized design division moved into their trendy new office in the Al Ezz building whilst also growing its international team of professionals. Miracle Prints launched the new Zeikon digital printing press with advanced personalization and high quality short-run capabilities. The first in the region. The publishing division has continued to orchestrate a number of prestige publications and increase its sponsorship of several of Bahrain's significant cultural events.

Since its acquisition by KFH-Bahrain, Miracle has seen stable growth in its revenues and operating performance.





REAL-ESTATE DEVELOPMENTS



DURRAT AL BAHRAIN	
Country	Bahrain
Year of acquisition	2003
Group holding*	50%

The Durrat Al Bahrain project is a world-class residential, leisure, commercial and tourist destination, offering a residential and urban lifestyle experience. The Durrat development is expected to accommodate 18,000 residents at full capacity, in addition to 5,000 visitors a day. The resort city will have around 2000 villas, hotels, a golf course, marina, shopping malls, and a theme park. The residents of Durrat will enjoy private access to the residential areas of the resort city. This will ensure considerable security and privacy to the residents. The facilities of Durrat will contribute to the development of the Bahraini economy by providing a significant number of job opportunities in a wide range of fields. Yet another notable feature is that expatriates will have the opportunity to buy and own properties in Durrat. Reclamation and revetment works are proceeding in accordance with the plan. A contract to build 13 bridges with a total overall length of approximately 3.5 km, has been awarded in September 2005 at a price which resulted in substantial savings in the total project costs, compared to the initial estimates.

The sales analysis, as of December-end 2005, looks impressive with sales exceeding BD140 million for Phases I and II. During the year, Durrat participated in different shows and exhibitions in the GCC countries to promote and market the project. The contract for construction of the first phase of villas is being awarded in the near future. The works on the new highway and electric power sub-station are being completed on a fast track and are expected to be complete within the target time period. Sukuk were issued to raise funds to finance the reclamation and development of the base infrastructure for the project. The issue was extremely successful and closed in January 2005 at US\$152.5 million with US\$32.5 million over subscription. During the year, three quarterly distributions were made to the Sukukholders.

* Including KFH-Bahrain's investors' share



ISHBILIYA VILLAGE	
Country	Bahrain
Year of acquisition	2005
Group holding*	100%

KFH-Bahrain, together with its affiliate have initiated a major real-estate project to develop a large plot of land in a prime location in the Al Qadam area of Bahrain. The aim is to provide modern accommodation for Bahrainis and the GCC residents. The entire Plot will be subject to a master plan which will include main and secondary roads, communal areas, and greenery. This will serve to create a pleasant environment in which to build residential units.

There is a shortage of middle-income housing in Bahrain at present and this shortage is forecast to increase as the population grows. The Ishbiliya Village project is expected to alleviate some of this shortage by offering residential units at a reasonable price.

* Including other investors



MEENA TOWER COMPANY

Country	Bahrain
Year of acquisition	2003
Group holding*	60%

KFH-Bahrain entered into a business venture with other notable investors in Bahrain to form the Meena Tower Company for the purpose of developing a real estate project.

The Meena 7 project comprises the construction of 213 condominium units in 7 buildings overlooking the beach at the southern entrance to Amwaj islands and the Floating City at the Northern end. The buildings are of various heights with a total floor area of approximately 31,000 m².

Since inception, the company management has made all efforts to ensure the successful completion of the project. A successful marketing and sales campaign resulted in almost 70% of the project being sold. On the construction front, the project is progressing ahead of schedule with the first apartments to be delivered during the first half of 2007.

INVESTMENT PLACEMENT

Liberty Aerospace Inc.

Offering Amount	US\$ 59.7 million
Target IRR	30%
Holding Period	4 years

KFH-Bahrain has successfully placed shares worth US\$52.7 million representing a 59% ownership interest in Liberty Aerospace Inc. As planned, KFH-Bahrain retained the balance holding of the placement amount. Currently, the bank and its investors collectively hold an indirect ownership interest of 75% in Liberty.

Ishbiliya Village Investors Limited

Offering Amount	US\$42 million
Target IRR	18%
Holding Period	2 years

KFH-Bahrain has successfully raised US\$40 million through placement of a 95% interest in Ishbiliya Village Project. The placement was over subscribed in record time. The targeted return for investors is approximately 35% over the anticipated 2 year investment horizon.

ASSET MANAGEMENT

Landmark One

Offering amount up to BD16 million (spread over two phases)

KFH-Bahrain has developed a highly innovative asset management product in the form of a Restricted Mudaraba Investment Account, attracting investors' funds on a co-investment basis with its bank's own funds, for developing major landmark real estate projects in the GCC region. The market response was very positive from a diversified set of investors including institutions.

In undertaking investments in each of these areas, KFH-Bahrain relied heavily on the expertise and know-how of its strong **investment professionals** as well as its extensive network of world class consulting partners that play an important role in deal origination and evaluation.



Back Row left to right:
Qossay Yaqoob, Thaeer Jamsheer, Mohammed Khalaf, Ali Rumaihi

Front Row left to right:
Salah Janahi, Abdul Razak Jawahery, Suhail Al Saati, Nader Fuad

Report of the Fatwa and Shari'a Supervisory Board

In the Name of Allah, the Beneficent, the Merciful. Praise be to Allah, the Lord of the Worlds, and peace and blessing be upon our Prophet, Mohammed, and on his scion companions.

To the Stakeholders of KFH-Bahrain.

Assalam Alaikum Wa Rahmat Allah.

In compliance with the letter of appointment, we are required to submit the following report:

We have reviewed the principles and the contracts relating to the transactions and applications undertaken by KFH-Bahrain during the period ended 31 December 2005. We have also conducted our review to form an opinion as to whether KFH-Bahrain has complied with Shari'a Rules and principles and also with the specific fatwas, rulings and guidelines issued by us.

KFH-Bahrain's management is responsible for ensuring that the Bank conducts its business in accordance with Shari'a Rules and Principles. It is our responsibility to form an independent opinion, based on our review of the operations of KFH-Bahrain, and to report to you.

We conducted our review which included examining, on a test basis, each type of transaction, the relevant documents and procedures adopted by KFH-Bahrain.

We planned and performed our view so as to obtain all the information and explanations which we consider necessary in order to provide us with sufficient evidence to give reasonable assurance that KFH-Bahrain has not violated the Shari'a Rules and Principles.

In our opinion:

- a) The contacts, transactions and dealings entered into by KFH-Bahrain during the year ended 31 December 2005 that we have reviewed are in compliance with the Shari'a Rules and Principles;
- b) The allocation of profits and losses relating to investment accounts conform to the basis that had been approved by us in accordance with Shari'a Rules and Principles;

- c) All earnings that have been realised from sources or by means prohibited by Shari'a Rules and Principles, have been disposed of to charitable causes; and
- d) The calculation of Zakat is in compliance with Shari'a Rules and Principles.

This opinion is rendered based on what has been presented to us by KFH-Bahrain's General Manager and its in-house Shari'a Advisor. We pray to Allah the Almighty to grant us success and the path of straight-forwardness.

*Wassalam Alaikum Wa Rahmat Allah
Wa Barakatuh.*

Ahmad Bazie Al-Yaseen

Chairman

Mohammed Fawzi Faidullah

Member

Khalid Mathkour Al-Mathkour

Member

Ajeel Jasem Al-Nashmi

Member

Anwar Shuaib Abdulsalam

Member

Mohammed Abdul Razaq Al-Tabtabaee

Member